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Examination of Key Factors Influencing International Franchisor's Entry Mode Choice in China

Mingxia Zhu

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Abstract

Market entry strategies of international franchising firms have been extensively researched. However, most of the studies focus on the cases of developed countries rather than developing countries. Since China adopted the open policy in 1978, Foreign Direct Investment (FDI) has grown rapidly and played an increasingly important role in contributing to the 9 percent of economic growth in the last two decades in China. Franchising, as an important entry method, has been adopted by many foreign investors to expand their business in China. Although the Chinese franchising market is still in its infancy, it creates tremendous opportunities for international franchisors.

This thesis attempts to determine the factors associated with the international franchising firms' entry modes choices when these international franchisors enter the Chinese market and to find the relationships between these factors and decision of entry mode choice. To achieve these objectives, the positivist has been chosen as the philosophical stance for this research. Consistent with this research paradigm, a structured survey was undertaken as the main research method underlying quantitative research methodology. After a pilot study, 400 questionnaires were conducted by sampling international franchisors in China in the main research. Based on the five developed hypotheses, the determinants of franchising entry mode choice have been tested by using a logit model.

The findings of this research reveal five important factors which dramatically influence international franchisors' entry mode choices in the Chinese markets. They are: culture and geographic distance, market operation experience, risk spreading, franchising system development stage and mature of the franchising system. Firstly, this study indicates that the less the cultural and geographic distance between the host and home country, the more likely the international franchising firms is to adopt direct franchising entry mode into Chinese market. Secondly, the richer experience the international franchisor, the more likely the firms is to adopt direct franchising entry mode into China. Thirdly, the higher the rate of the expansion of the franchising system, the more likely the firms is to adopt direct franchising entry mode in China. Fourthly, the more mature the international franchising system, the more likely the firms is to adopt direct franchising entry mode in China. Finally, the more consideration of risk spreading, the more likely the firms is to adopt direct franchising entry mode in China.

This study offers a number of distinctive contributions from both academic and practical perspectives. Theoretically, this study has advanced the current literature of international franchising by examining cases in the emerging market of China and added more insights to the mainstream of franchising theories. Most importantly, it provides a guide to assist practitioners deciding their franchising entry modes effectively and offers valuable suggestions for policy makers in their foreign policy development regarding international franchisors' business operations in China. Significantly, this study provides timely information for academics and practitioners concerning the current status of international franchisors' business in the Chinese market.

Declaration

I acknowledge that the work presented in this thesis has not been submitted for any other award, except that entailed by research training purposes during my DBA (Doctor of Business Administration) studies at Newcastle Business School of Northumbria University of Newcastle. I have completed the required research training and milestones required for the degree. The work is the result of my individual work.

Name: ZHU Mingxia

Signature:

Date: 2007

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Chapter 1

Introduction

1.1 Introduction

In this chapter, the author provides an overview of how this thesis has been conducted as a whole process in answering the question: what factors affect international franchisor's modes of entry choices in China? The author initially reviews the existing findings on the relationship between factors and international franchisor's market entry modes to explore the importance and relevancy of this thesis. What follows are the research targets and objectives. Finally, the logical structure of this thesis is outlined at the end of this chapter to help readers understand this research as a whole picture.

1.2 Background to the Research

1.2.1 Reasons of Choosing China as the Research Target

Emerging markets, accounting for 80 percent of the world's population and 60 percent of the world's natural resources, represent the most dynamic potential for long-term growth to businesses in general and to franchisors in specific. (Welsh and Alon, 2001). In addition, 'Big Emerging Countries' (such as China) in total account for more than half of the world's population but produce a mere 25 percent of its gross domestic product (Welsh and Alon, 2001). Sinclair and Xiong (2006, P57) indicate that "China is one of the largest emerging countries with tremendous market potential." Nevertheless, McDonalds', which franchises 69 percent of its

restaurants outside the US and 83 percent of its restaurants in Spain, operates only one franchised outlet out of 750 restaurants in China in 2005. Similarly, KFC, the leading food service brand in China with revenues of RMB 12 billion in 2005, only operates 4 percent of its 1,530 outlets in China as franchises". This begs the question: Why do these multinational franchisors have such limited franchise operations in such a huge potential market? What factors influence international franchisor's entry modes choices if they are interested in the franchising business market in China? However, reviewing the existing theories, little research has been conducted on the key factors affecting international franchising entry mode choices in the context of entering Chinese market (Zhou, Li and Tse, 2002)

Since China became a member of the World Trade Organization (WTO), more and more areas of the Chinese economy and more marketplaces have been opened to foreign investors. One of the most dynamic areas is franchising. Sinclair and Xiong (2006, P57) also clarify that "franchising systems were first rolled out in China by domestic companies in the early 1990. The sector entered a period of rapid growth from 2000 onwards, and by the end of 2005, the number of franchise systems in China amounted to 2,320. Despite the size of China's franchise sector, it is actually still in its infancy, and still has much scope for future development". A relatively recent regulation passed by the Chinese government opens vast, virgin, and hugely profitable territories for companies seeking franchising opportunities in China.

Sinclair and Xiong (2006) state that sales revenue from franchise systems accounts only 3 percent of total retail sales in China, compared to an average of 40 percent in the developed markets. In addition, although China is the global leader in terms of number of franchise systems, each system only averages 72 outlets which is much lower than the average of 540 outlets in the United States.

In view of market entry strategy in China, most past studies concentrated on the foreign direct investment (FDI) flowing into China, while there is a significant lack of academic studies and empirical research international franchising as an alternative. Although some studies about international franchising in the Chinese market have been conducted, i.e. English and Xau (1994) explored franchising in China by reporting on the entrance into and subsequent experiences of two U.S.-based franchises in China: Kentucky Fried Chicken (KFC) and McDonald's. Alon, Toncar, and Lu (2002), Alon and Bian (2005) provided a review of the restaurant and professional services, respectively about China. Nevertheless, specific research on the franchising market entry strategic choices is rare.

1.2.2 Background to the Research

The present literature has shed little empirical light on the study of franchising in the specific context this thesis. For example, most existing empirical studies are based on franchisors from developed countries; no particular attention has been paid to emerging countries, such as China. This thesis is set to examine international franchising firms' entry strategies

in the context of the Chinese market.

China's recent domestic investment environment has made China an extremely lucrative market for multinational franchisors who wish to enter. According to statistical data, the current Chinese franchising market, estimated at US\$ 25 billion and 2.4 million job opportunities, is growing at an annual rate of 53 percent (China Chain Store and Franchise Association, 2005). So far, 70 percent of the top twenty franchisors and 36 percent of the top 200 of the global franchising giants have already entered the Chinese market. Franchising in China is in its steady but rapid-growing stage. The total number of franchising systems has increased to 2,320, increasing annually by 10.5 percent (CCFA, 2005). The actual number of outlets has increased by 38 percent bringing the total number of outlets to 168,000 (CCFA, 2005).

Teegan (2000) points out that for the past twenty years, firms have undertaken internationalization as an important strategy to expand their businesses overseas. Historically, investors from developed countries have played an important role in international franchising development. The globalisation of franchising has flourished due to the trend in many countries to remove protective barriers and encourage foreign investment. Whereas many developed countries such as the United States, Canada and sections of Western Europe are reaching domestic market saturation, there is plenty of scope for franchisors to expand their business into emerging markets.

As a key issue, a firm's internationalization has been studied from different aspects in international business research (Buckley and Ghauri, 1999). As a frontier issue, the choice of foreign entry mode has been recognized as an important decision when a firm decides to expand their business overseas. This is that market entry mode has much to do with the success of a firm's international performance (Choo and Mazzarol, 2001). Therefore extensive empirical research and theory development have been conducted by many international business researchers (e.g Anderson and Gatignon, 1986; Dunning, 1988; Hill, et al 1990). But not a great deal has been done with regards to emerging markets.

As a brand-new means of business operation in China, franchising has already become one of the most attractive methods for foreign companies to enter this new foreign market. However, given the rapidly changing laws and regulations as well as the different culture, international franchisors should take extra care when making their strategic market entry decisions to enter China, a country on the path to becoming a market economy. To date, little research has been done in this area (Li, 2003).

The study of China's case is of great academic interest and significance. The economic reform policy initiated by Deng Xiaoping in 1979 ended 30 years of isolation. Since then, China has become the world's 5th largest economy, increasingly attracting the attention of foreign investors. By 2006 there were more than 570,000 foreign firms in China (Song, 2006). International franchising has become one of the most important market

entry strategies for foreign firms to extend business to Chinese market across many industries. China Franchising Association statistics show that at present there are in total about 2320 franchising systems in China now, which includes over 500 international franchising systems. China Chain and Franchise Association's (CCFA) survey also reveals that there are at least 3,000 international franchising systems that are closely monitoring this market. Experts find out that at least 2000 international franchisors are planning to enter into this market in the relative near future (CCFA, 2006).

Reviewing the research development of franchising in China in the last five years, the writer finds that the current studies were mostly targeted on Chinese domestic firms, focusing on how these Chinese firms use franchising as means to further develop their domestic market in China. On the other hand, although there are a lot of publications about international franchising, most attention has been paid to the developed franchising markets, such as those in the U.S.A., Europe, and Japan with little research focused on developing markets. This is particularly true in the case of China, where there has been little effort to date to examine the determinants of international franchising firms' market expansion in China, especially in their entry strategic choices. This gap in the research encouraged the author to investigate what factors affect international franchisors' entry choices from a quantitative perspective. Empirical research has been conducted in an effort to reveal the specific factors that need to be taken into account by international franchising managers who are ready to launch their market entry in the Chinese market. Further effort is made to understand why and

in which context, some factors are more important than others.

1.2.3 Reasons of Studying International Franchising in China

A comprehensive literature review has shown that the past empirical studies of international franchising heavily focus on franchising firms based in the developed countries. As China is one of the major players in the global economy, China will remain attractive to international business researchers in single country studies, namely, those that provide some analysis of the business relationships between a single country and China. Given a noticeable research gap on franchising market entry strategies adopted by international franchising in developing markets, this research study is focused on how and under what circumstances the existing theory of international franchising (based in developed countries) can be applied to the firms in developed countries when they attempt to enter a developing country, such as China.

Given the fact that the bulk of research studies have emanated from USA (significant US based research studies), doubts however, may be raised as to the general liability of these findings and whether the patterns observed in the US are prevalent in the internationalization of non-US companies. Despite the growing popularity of franchising as a market entry strategy for international franchising firms, the research community has not yet begun to examine international franchising within the context of internationalization (Sanghavi 1991; Whitehead 1991; Manaresi and Uncles 1995; Sparks 1995), especially about the entry strategy in China. Existing research about international franchising in China is too general.

Further investigation of what factors influencing international franchisor's entry mode choice is required. As the business environment within China is becoming sounder and as China becomes more involved in international business, especially since joining the WTO, the still virgin Chinese market makes a beguiling target for multinational giants. But the research on "how" to best franchise in China is rare (Niu, 2001).

On the other hand, as seen in the literature review, current research about franchising in China seems mainly focused on the basic concepts, such as franchising situations, problems and some business reports. This research differs in that it is focused on what main factors influence international franchisor's market entry strategy in China.

Studies on the international franchising entry modes in developed nations, such as UK, U.S.A, Singapore and Australia, grasp much attention from researchers. Although many researchers have showed great interest in international franchising, much of the research was conducted on local franchising. For instance, Chong and Goh (1993) investigate the strategic and competitive aspects of franchising in the local food industry by surveying 180 people who spent about 20 percent to 40 percent of their income on food in Singapore in 1993. Robinson's research provides only qualitative and strategic insights into Singapore's local franchising (Robinson, 1994). There is comparatively scarce study on international franchising in Chinese market.

From the above, it is shown that despite the considerable progresses made

in international franchising research thus far, the studies on factors influencing the entry modes of international franchising in China are rare. Franchising is still a new phenomenal concept in China (Niu, 2001). In fact, it was only in November 1997 that China's Ministry of Internal Trade promulgated the Regulation on Commercial Franchise Business (For Trial Implementation), thereby creating a potentially potent vehicle for the entrepreneur seeking to develop franchising opportunities to profit from China's huge marketplace. Yet there has been little academic attention paid to the choice of strategies used by franchisors to implement their systems overseas despite the growing trend towards international retail franchising as a means of expansion beyond the domestic market (Quinn and Doherty, 2000).

Because all the market entry modes involve resource commitments, the franchisor's initial choice of a particular mode is important in preventing the unwarranted loss of time and money. How to evaluate a host country's risk and potential investing profits? What factors must be accounted in international franchising decision-making in order to adopt appropriate entry mode? The purpose of this DBA thesis is to advance the knowledge and practice in the area of international franchising firms' market entry strategy in China. It aims to make a contribution to business and management practice in relation to franchise decision making.

1.3 Research Questions

Welsh, Alon and Falbe (2006) comment that many authors have examined

why franchising, as a valuable business model, has had such an impact internationally and what forms franchising has taken in different parts of the world. For example, Grimaldi (1992) analyzed the opportunities for franchising in free-trade zones. Kaufmann (2001) inspected the issues of cultural and legal differences in the age of the Internet and the impact of retail franchising on host-country development. Specifically, he investigated already proven concepts in retail franchising, modes of entry, cultural and legal differences, host-country development, and technological advances. Additionally, Stanworh, Price, and Purdy (2001) deemed franchising as a means of technology transfer for developing economies.

Their articles explored the background inherent in the internationalization of franchising, including favourable factors to growth, benefits to developing economies, potential consequences to developing economies, advantages and risks to franchisors, as well as government action to encourage retail franchising. These authors discovered factors that are favourable to the growth of franchising, such as growing urbanization, rising disposable incomes, and expanding consumer markets. The benefits to developing countries were also identified from managerial, marketing, and consumer know-how perspectives.

Studies on the international franchising entry modes in developed nations, such as UK, U.S.A, Singapore and Australia, grasp many international researchers' considerable attention. Although many researchers have

shown great interest in international franchising, many studies were only conducted based on local franchisors operating domestically. For instance, Chong and Goh (1993) investigate the strategic choices and competitions of franchising in the local food industry by surveying 180 franchisors who spent about 20 percent to 40 percent of their income on food business in Singapore in 1993. (Robinson, 1994). Nevertheless, there is little research that focuses upon international franchising entry modes choices.

As mentioned earlier, a lot of research was done by sampling developed countries, but recently, research attention has been switched to emerging countries, such as India. Paswan (1993:P20) indicates that ‘when entering the Indian market, multinational franchisors (mostly from North American or Europe) have so far primarily relied on two entry modes, one is joint ventures that have eventually evolved into franchised systems, the other is wholly-owned operations’. To have a comprehensive understanding of franchising business in emerging markets, studies on this area have been summarized by Welsh, Alon and Falbe (2006) (See Appendix 1) which represents relevant international franchising articles mainly published in US from 1998 to 2005, including years published, titles of article, and authors.

The author finds that that from 1998-2005, there are in total, 31 articles published in the United States about international franchising in emerging countries; amongst them, only 4 articles are about international franchising in China. One article is written by Alon in 2001 entitled ‘International Franchising in China: An Interview with Kodak’; another is written by

Alon, Toncar, and Lu in 2002 with the title of ‘American Franchising Competitiveness in China’; the final one is written by Alon and Bian in 2005 under the title of ‘Real Estate Franchising: The Case of Coldwell Banker Expansion Into China’. Not any of these articles studies the factors influencing international franchising entry mode choice in China. In the light of a huge research gap in this area the author intends to fill it by conducting this research.

Although franchising is expanding faster and more vigorously than other expansion form (Castrogivanni and Justis, 1998), the factors affecting the international franchising entry mode choice are understudied. Each investigation, whether descriptive or theoretical, conceptual or empirical, raises the basic question of how international franchisors select and recruit partners. The research question raised in this paper has rarely been directly addressed. Admittedly, the general international franchising literature does provide some insights into what factors influence the international franchisors’ entry mode choice, there are distinct difference between this previous research and what is being investigated here. Firstly, previous studies examine the reasons why a domestic franchise business would internationalise its already operational franchise business while he thesis notably reveals what factors affect international franchisors’ market entry mode choice in China. Secondly, the previous work sampled in developed countries whereas his research will focus on emerging countries, especially China. Finally and significantly, this thesis examines, for the first time, the specific factors influencing international franchising entry mode choice in

China, and conversely previous studies on international franchising have not been specified to this extent.

To provide novel insights, this DBA thesis sets out to advance knowledge and practice in the area of international franchising in China with special focus on international franchisors' entry mode choices. It is dedicated to serve international franchising management practitioners in relation to their franchising entry mode decision making. Coherent with these research objectives, the research question addressed in this study is:

What are the key factors influencing international franchisor's market entry modes in China?

To facilitate understanding of international franchisors entry mode choice in China, the following research questions are developed:

- (1) What are the motives of international franchisors entering the Chinese market?
- (2) What factors influence international franchisor's entry mode choices in China?
- (3) What international franchising entry modes were adopted by international franchisors when they entered the Chinese market?

1.4 Aims and Objectives

Due to the fast growth of franchising businesses in emerging markets, both academics and practitioners are trying to seek solutions of how to run franchising business successfully in these new markets. As a result, this

requires more research in this area. However, relevant research regarding this issue is limited.

On the basis of the above research questions, the primary objectives of this research are:

- (1) To find out the motivations of international franchisors entering the Chinese market.
- (2) To determine the key factors associated with the entry mode choice of international franchisors in China.
- (3) To find the relationship between key factors and entry mode choice of international franchisors.
- (4) To contribute to the literature by presenting empirical findings on factors influencing international franchisors' entry mode in China.
- (5) To develop a practical framework of entry mode choice and guide practitioners to choose optimal franchising entry mode for international franchising companies.

1.5 Organization of This Study

This DBA thesis includes seven chapters. In Chapter One, the overview of this thesis is presented. To draw a whole picture of this study, research background is presented with a brief reviewing of existing literature in relation to international franchising business. After that are the research questions and objectives are addressed, which are followed by the overview

of the research methodology employed for this study. This chapter ends with the introduction of the structure of the thesis.

In order to build a theoretical foundation upon which this research is based, Chapter Two concentrates on a review of the theoretical background and literature which is relevant to this study undertaken. By critically examining the existing theories of international franchising that have been carried out based upon franchising firms from Western developed countries, the research of the thesis identifies and highlights the gaps in the field. Accordingly, five hypotheses are developed to be tested.

Chapter Three provides a detailed review of the international franchising in China. Chapter Four describes the philosophical paradigm upon which the methodology was built for this study. Justifications of methodologies and methods used for data collection and analysis in this research are introduced.

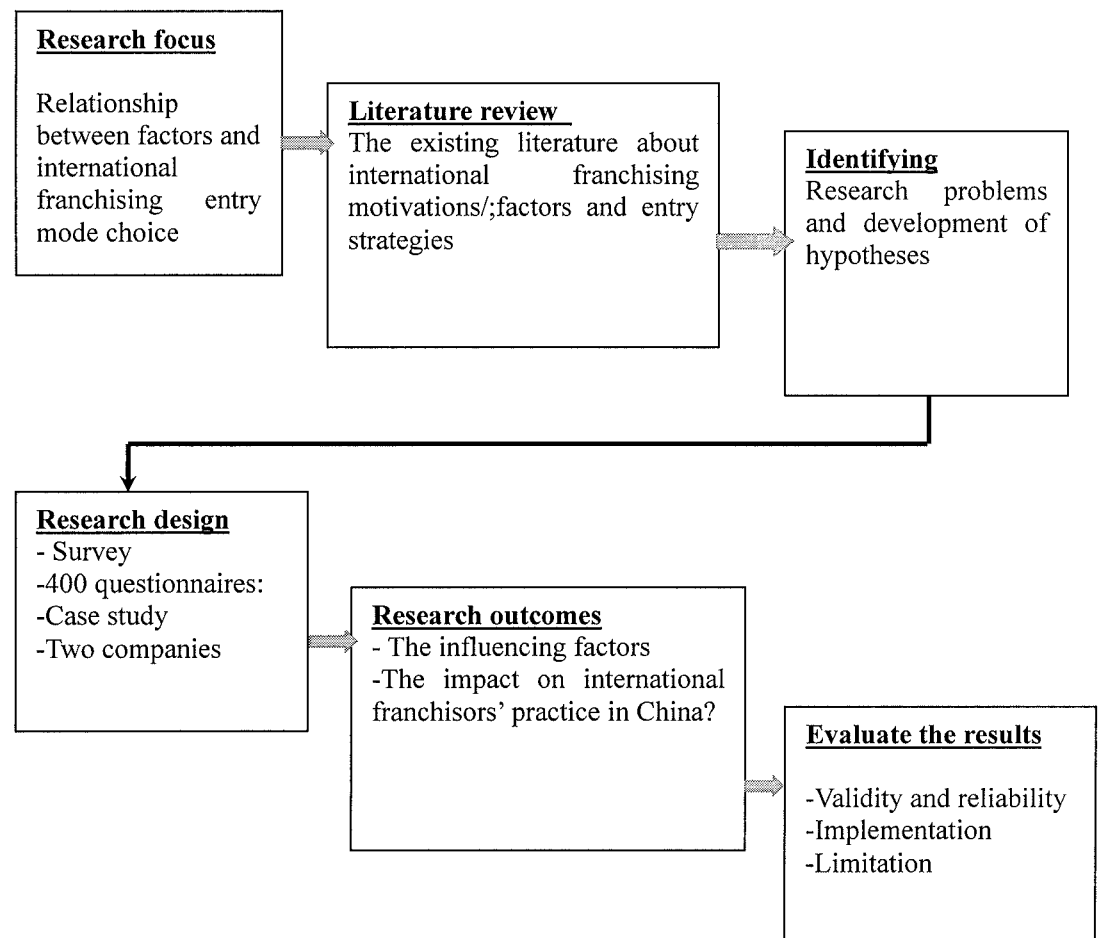
Chapter Five focuses on the findings and analysis of the research and provides the full picture of the findings within the main body of knowledge in relation to international franchisor's modes of entry into China. In this chapter, the author first presents questionnaire analysis, then summarizes and discusses the statistics of firm characteristic and finally discusses the testing of hypotheses. The open questions in the questionnaire are discussed and summarized at the end.

In order to strengthen the research results, two case studies of pioneering American fast food companies are conducted in Chapter Six.

Moreover, the theoretical and practical contributions of the study are discussed in Chapter Seven. It sums up the contribution to theory as well as to business and management practice. Furthermore, the author makes reflection on personal and professional development and points out the limitations of the research as well as future research directions.

The whole research process is designed to follow the sequence, as indicated in Figure 1.1 below.

Figure 1.1 The Sequence of the Research Development for this Thesis



1.6 Chapter Summary

This chapter has provided a picture which aims to help readers follow the research and understand how this study has been designed, developed and conducted. It provides the reader with a background into the research question of what factors influence international franchisors' entry mode choices when entering the Chinese markets. Furthermore, this chapter outlines the whole research process. It provides readers with an overview of the content of chapters to follow. Based on this foundation, a discussion of the exiting literature is to be presented in Chapter Two.

Chapter 2

Literature Review

2.1 Introduction

This chapter will review the literature that has evolved in the key areas of franchising entry modes. Related issues with respect to the introduction of international franchising, the reasons for franchising, the relationship of conventional theories factoring foreign market entry mode decisions, would also be dealt here. Relevant theories and propositions of resource scarcity and agency aspects would be analysed in order to establish the fundamental reasons for international franchising. The intended outcome of this insightful literature review is also to probe the factors such as culture and geographic distance, international marketing experience, risk spreading, developmental path, life cycle, etc.

2.2 The Concept of Franchising

Franchising is an organisational form in international business that enables the principal organisation (the franchisor) to facilitate the local operator (the franchisee) to sell a product or service using trade name owned and developed by the franchisor (Rubin, 1978). The framework of franchising is characterised by a system and a network. The distinctive characteristics of franchising vis-à-vis other enterprises such as food production, insurance, or banking is the manner of conducting the business. Franchising may be termed as a dynamic and evolving format of doing business. Among various definitions, the one posited by Freeman (1993) entails franchising

being an entrepreneurial technique that enables the franchisee to run the business by purchasing the right to use an established concept including the brand name that is legally protected. The brand is manifested as a product or as a service. The definition also incorporates the as key franchising functions, viz, supply, distribution, marketing, and allied support system. This definition purports that others have invested financial resources, time, and effort to build a successful firm in which an individual can legally participate without the risk of entering unknown areas unsupported.

The inception of franchising dates back over one hundred years, (1900) and evolved as a popular practice. This rather unique form of doing business has its roots in key regions around the United Kingdom, France and Japan. This proliferated to developing countries, such as India and China. In mid 1980s, international franchising entered into China (Niu, 2001).

Delving into the historical background (18th century) German brewers adopted business franchises to control the distribution of their products as well as services through beer halls (Hoffman and Preble 1991). The introduction of trademark into the franchising system was the evolution of the franchising system so as to provide brand identity (Dant, Paswan and Kaufmann, 1996). The franchisor provides its trademark and operational support in exchange for franchise fees and on-going royalties.

Franchising is an organizational form in which a company grants an individual or another company the right to do business in a prescribed manner over a certain period of time in a specified place in return for

royalties or the payment of other fees (Niu, 2001). According to the United States Department of Commerce (1988), the company sanctioning the right or owning the trademark is termed the franchisor, while the unit that receives the aforesaid right is termed as the franchise. The operational establishment or the location where the franchising operation is conducted is called the franchised unit (Elango and Fried, 1997). A franchisor usually has a number of franchised units. Usually, among the various kinds of franchising, a key type is the direct franchising, wherein the franchised units are owned by the franchisor and are operated by its employees. The franchisor, the franchisee units, including both franchised and company-owned, constitutes the franchising system.

Franchising systems are broadly divided into two relationship categories, viz, the Product Trade Name franchising and the Business Format franchising. The Product Trade Name franchising is a relationship between the supplier and the dealer in which the dealer agrees to acquire some of the identity of the supplier in order to become the preferred source of the supplier's goods. Business Format franchising envisages an ongoing relationship between the franchisor and the franchisee. In the latter the emphasis is on a relationship between the franchisor and the franchisee, that not only includes product, service, and trademark, but also the entire concept of the business (U.S. Department of Commerce 1988).

2.3 An Overview of the Literature about International Franchising

2.3.1 Focus on the current literature on International Franchising

In the new millennium (2000), the key to international franchising is based on well defined contractual arrangements that allow franchisors to enter overseas markets (Teegan, 2000). Researchers have redefined the role of franchising in establishing a global enterprise. Franchising is now internationally recognized as a strategic tool to go global that depends on networking within some business sectors (Fladmoe-Lindquist, 2000; Hoffman and Preble, 2004; Altiney, 2004). International franchising provides an excellent opportunity for business expansion (Altiney 2004). Market entry strategies incorporate international franchising as a way to diversity into new international markets (Burt, 1993; Quinn and Doherty, 2000; Quinn and Alexander, 2002). International franchising research has been dominated by studies on examining how companies bring their tried and tested international franchising to new markets (Huszagh, Huszagh, and McIntyre,, 1992; Kedia, Ackerman, and Justis, 1995; McIntyre and Huszagh, 1995; Teegan, 2000; Sashi and Karuppur, 2002).

While determining the entry mode into a new global market a number of issues are addressed (Mendelsohn, 1989, 1992; Justis and Judd, 1998; Chan and Justis, 1992). Distinguished international franchising researchers, viz, Aydin and Kacker (1990), Welch, (1989, 1990), Abell (1991), Preble and Hoffman (1995) have focusing their studies on the direction of international expansion. Operational issues such as control was studied by

Grub (1972), while service support with respect to international franchising was posited by Falbe and Dandridge (1991) and Kaufman and Leibenstein (1998). The contribution of eminent researchers was to examine the uniformity of offering (Walker and Cross (1989), Preble (1992), Welch (1992), Hopkins (1996).

The internationalization of U.S. franchising systems presents valuable insights into this key research area of International Franchising (Alon, 1999). Classification of the theories of international franchising into two research streams is the outcome. One research path focuses on environmental variables, while the other focuses on the organizational capabilities of the franchisor. These new incorporations of two-pronged research theories emanated from the embryo works of Hackett (1976) and Welch (1989). Hackett (1976) was among the leading pioneers in the field of international franchising research. His contribution is to identify a salient trend of saturation in the domestic markets. This caused the franchisors to probe into other alternate markets, especially abroad.

Researchers propose that franchising essentially follows a life cycle. This commences with the internationalization of the industrial markets which are similar in nature and follows a pattern like in case of the United States, Canada, the United Kingdom and Australia (Welch, 1989). The next phase of the life cycle encompasses expansion into dissimilar developed markets, such as Japan. In the next phase, the life cycle progress matures into emerging markets that are culturally distinct and economically less developed. The cycle achieves completion when franchisors from the emerging markets (including the economically less developed countries)

enter the original home markets and begins to compete with the founders of the original brands. Empirical evidence (Retail Intelligence, 2001) reveals that more than 33 percent of the 94 United Kingdom based international retailers have diversified to international markets (34 units). In spite of this growing importance of proliferation of International Franchising, there is limited availability of academic research in the field. Nevertheless, a growing fraternity of researchers have identified the practical implications of International Franchising research. They include distinguished researchers, viz, Quinn and Alexander 2002; Petersen and Welch 2000; Doherty and Quinn, 1999; Quinn 1998a,b; Sparks, 1995, 2000).

Initially the basic international franchising research adopted a cross-sectional approach to the study of the activity. Large quantitative surveys were conducted in order to examine the franchising framework by manufacturers and a host of service providers (Hoffman and Preble, 2004; McIntyre and Huszagh, 1995; Walker and Cross, 1989; Hackett, 1976). However these studies did not examine the dynamics and specifics of internationalization of franchising. A limited range of franchising issues such as in-depth company experiences (Sparks, 1995; Quinn, 1998b), power and control in international franchising (Quinn, 1999; Quinn and Doherty, 2000) and the theoretical development of international franchising (Doherty and Quinn, 1999; Quinn and Doherty, 2000; Doherty and Alexander, 2004) were conducted. There exists a gap in this key field of international franchising research. Hitherto, such research did not

attempt to examine the factors that influence the international franchising companies who plan to enter the emerging markets such as China through the franchise mode of operation. The emergent need for sector specific research is accentuated as the current body of research tends to focus largely on the US market (Walker and Etzel, 1973; Hackett, 1976; Aydin and Kacker, 1990; Kedia, Ackerman, Bush and Justis, 1994; Huszagh 1995). Hence, this dissertation thesis aims to address this research gap.

It is comprehensible that there is no defined definition of what constitutes the emerging market (economy). For a realistic attribute set for the emerging market (economy), one may look at the three characteristics (Czinkota and Ronkainen, 1997). The three tenets are: level of economic development, economic growth, and market governance. A number of authors, both industry analysts and academics, have identified emerging markets as a topic that needs further research (Kaufmann and Leibenstein 1998). Researchers did respond to this call. The first survey on franchising in Russia (Welsh, 1990) that coincided with the inaugural franchise of McDonald's in Moscow is a case in point. This received accolades and welcome from the Russian people and press. As a logical follow-up, an empirical study was subsequently conducted (Welsh and Swerdlow, 1991). The franchise mode of market entry in emerging markets grew dramatically since the 1980s. For instance, by 1995, twenty-six franchisors were added in Brazil. This number is by far larger than the aggregated figure in entire South America in the year 1985 (International Franchise Research Centre, 2000). By 1997, the top 50 U.S. food chains had \$33.1

billion in international sales because of the significant efforts made by large U.S.-based food retail franchisors (Breuhaus, 1998).

This recent surge franchising as a mode of entry into evolving emerging markets has obvious implications. The research relevance in this key area of franchise practice has drawn the attention of the academia, on one hand and focus by practitioners, on the other (Welsh, Alon and Falbe, 2006). Detailed review and research summary in the retail franchising in emerging markets are available (Alon and Falbe, 2006). Hitherto, the traditional research on franchise management was generally found in leading journals, amidst other topics. But now, franchise-specific sources of information are being circulated among the key academic segment. The review (Alon and Falbe, 2006) incorporates journal articles, the proceedings of the International Society of Franchising for the period 1986 to 2007. Relevant topical articles in books, publications and journals on International Franchising in Emerging Markets are now available, viz. *Franchising Research: An International Journal*.

The spotlight on Asia on this subject of Franchising in Asia started since 1995. A key document is the survey report on foreign franchises that were desirous of entering into the Asian markets of Singapore, Malaysia, Hong Kong, and Indonesia (McCosker (1996). This treatise collated information from the existing literature as well as through interviews with franchisors that had already entered these markets. Another couple of publications reported on a survey that identified the existing major franchises, the

different types of franchises, and the nature and characteristics of the franchise agreements in Singapore (Chan, Foo, Quek and Justis, 1994) and the understanding of the *modus operandi* of franchising in East Asia (Chan and Justis, 1995). This was followed up with a survey of 62 franchisors in Singapore (Goh and Lee, 1996). This study assessed the state of retail franchise development, the franchise fee structures, the prevalence of home grown franchises, and the effect of the government's efforts to promote franchising. Yet another contribution examining franchisee satisfaction and the intention to remain in the franchise system in Taiwan, added to the focus on Asia Pacific with respect to Franchise practice (Chiou, Hsieh, and Yang, 2004). The South East Asian case of franchising in Indonesia investigated the climate for franchising and the perceptions of the Indonesian people toward franchising (Chan and Justis, 1995).

Irrespective of the bi-lateral relations between the United States and China, there is ample evidence of the Chinese affinity to the concept of franchising that evolved in the developed countries. In spite of sporadic aberrations in bi-lateral relationships, like the one when an U.S. surveillance plane went down on Chinese soil (April 2001), there was no diminution in patronizing the Pizza Hut franchises by Chinese consumers. Empirically, there are several franchise outlets, including Starbucks Coffee, Kenny Rogers Roasters, Pizza Hut, KFC franchises and McDonald's (326 outlets for McDonald's in that period (Friess 2001). Due to industry restructuring, China (not unlike Russia), markedly changed the conditionality requirements for new franchisees.

2.3.2 Models of International Franchising

Driven by the growing significance of international franchising, two major models have evolved. The former is based on the organizational characteristics. Firm attributes like size, age, growth rate, fees, royalties, physical dispersion, et al form the cornerstone of the model. This model is built on the foundation of agency and resource-based theories. The agency and resource-based theories did provide research based explanation for the process of internationalization of the franchisors from the United States of America (Alon, 1999).

The latter model focuses on the core elements ‘mandatory prevalence of modules’ and the ‘menu modules’ (Haueter, 1983). This model is pioneering for being the first to examine marketing through the afore-mentioned modular system. It is also unique as this approach was the first to develop the core elements, secondly, to standardize the core elements and thirdly, had the option to adapt peripheral elements. This modular concept was applied to three international retail franchises, viz, McDonald’s in the United States of America, and Cash Converters & CarLovers, both from Australia (Thompson and Merrilees, 2001). These case studies provided the much needed research justification. Thus, the veracity and the practical applicability of the modular approach to international franchise research were, to a great extent, established. This also added the international applicability of the modular approach irrespective of the franchising system’s origin. It was argued that all franchisors contemplating to go international into emerging markets could

benefit from such a modular approach, comprising of a system including the three modular subsystems, viz, marketing, branding, and operations. Each subsystem required a core and along with certain ‘menu elements’. The cultural milieu of the host country was posited to be the determinant and the critical element for the development of successful franchises. Characteristically, the emerging markets are heterogeneous rather than homogenous. In such a diverse cultural heterogeneity, the localized traits of culture would determine the formation of the menu items. However, further research is necessary to authenticate the veracity of these key concepts in model development. The context of the aforesaid contentions were not applied and empirically tested as a market entry mode with respect to the entry into the China. Hence, this research has the opportunity to address this gap, wherein, the objective of this research study is to identify the factors that affect the choice of the international franchising entry mode especially in China.

2.4 Motivation of International Franchising

2.4.1 Drivers of International Franchisors

International franchising is a contractual arrangement that allows franchisors to enter overseas markets (Teegan, 2000). The drivers, aspects and propellants that motivate international franchisors to enter international markets are elucidated as follows (Doherty, 2007):

- Sudden and often fortuitous franchisee expressions of interest and ‘feeler’ contacts from third parties (Walker and Etzel, 1973; Hackett, 1976; Walker and Cross, 1989; Welch, 1989, 1990; and Abell, 1991)
- For the purpose to explore potential markets (Hackett, 1976; Hoffman

and Preble, 1993; Welch, 1990; and Hopkins, 1996)

- In pursuit of the objective of increasing sales and profits (Trankheim, 1979; Kedia et al, 1994; and Hopkins, 1996)
- For market expansion (Trankheim, 1979; Kedia et al , 1994; and Eroglu, 1992)
- Franchisors desirous to become an international firm (Trankheim, 1979; and Hopkins, 1996)
- When there is perceived favourability of the external environment vis-à-vis the domestic locale of the franchisor (Eroglu, 1992; and Hoffman & Preble, 1993)
- Considerations related to the firm size (Eroglu, 1992; and Aydin & Kacker, 1990)
- Aspirations of relatively quick growth (Walker and Cross, 1989)
- Franchisors' knowledge pool on operating experience including that of the top management internationally, tolerance for risk, clarity of the perception of the firm's competitive advantage, influence by external change agent (Eroglu, 1992).

Hence, it is observable that increased sales and profits, market expansion and a desire to be known as an international firm are the prime drivers for the international franchisors (Tranheim, 1979). That growth is the main reason for franchisors to move into international arena, was corroborated by subsequent research (Walker and Cross, 1989), wherein, both international and non-international franchisors were included in the sample set. The market saturation in the United States during the early 1990s,

provided further motivation for franchisors to focus on global markets that were underdeveloped and had the potential to offer high growth rates (Hoffman and Preble, 1993). The firm size (Aydin and Kacker, 1990), the attitude of top managers (irrespective of firm size and firm characteristics) (Kedia et al, 1994), are significant variable that need to be understood in this research for the determinants of the decision of international franchisors. The study of the process of internationalization of the US franchisors identifies the key reasons as to obtain additional profits or higher margins, exploit a unique product or service, become international and exploit a technological advantage (Hopkin, 1996).

Analysis of the literature further reveals that the most important factor influencing the US-based franchisors to market overseas was the firm's desire to exploit potential international market places (Hackett, 1976). This also includes the desire to establish a brand name while taking addressing emerging markets with great potential. Many franchising firms are able to enter overseas markets without any change in their marketing strategy and experienced the same level of profitability as they do at home. International franchising also offers a strategic option for firms who do not franchise domestically. In case of high tech products, an international market expansion through franchising can offer many advantages, viz, higher value accrual to the product, improved provision of services provided by the franchising system and the augmentation of the scale of advantages of franchising (Ayal and Izraeli, 1990).

There is often the argument that finds that international franchising could face meagre growth in countries where the population is large, yet per capita spending is not sufficient. In such a situation, the firms could convert this situation into an opportunity by establishing a presence in such countries that are poised for a major expansion effort (Whitehead, 1991). There are legal and governmental red tape that act as entry barriers (Hackett, 1976; Walker & Etzel, 1973). Other obstacles are the lack of international management expertise and limited financial resources within the domestic market (like that of the United States of America) (Aydin and Kacker, 1989). These factors acted as hurdles for the franchisors and they chose to remain domestic. A significant learning outcome from research is that firms whose managers are favourably predisposed to internationalization are more likely to pursue international opportunities (Kedia, Ackerman, and Justis, 1995). Franchising has spread internationally in two stages. Initially it spreads to countries characterized by high per capita income and a developed retail service sector; then to countries characterized by greater diversity in culture, income, and political systems (Welch 1989). This internationalization of franchising has been of interest to many groups, such as academics, business executives and government decision makers, although the research is largely a theoretical.

Franchising has become an increasingly important marketing strategy in global market. Early studies provided some explanation why the firms adopt international franchising. The major motive for franchisors to move overseas was a desire to take advantage of markets with great potential and

to establish a brand name (Hackett, 1976). While for high tech products, an international market expansion through franchising could offer many advantages including higher value accrued to the product due to the services provided by the franchising system coupled with the scale advantages of franchising (Ayal and Izraeli, 1990). Researchers argue that international franchising provides an opportunity for firms to establish a presence in countries where the population or per capita spending is not sufficient for a major expansion effort (Whitehead , 1991).

While summarizing the theories and analyzing the evidences of franchising, one concludes that research on the area of international franchising has not utilized the existing theory base (Elango and Fried, 1999). The application of resource scarcity and agency theories could be further researched and investigated in order to explain franchising in an international setting. Hence, it is essential to develop contextual conceptual frameworks to improve the understanding of international franchising (Quinn and Doherty, 2000).

The decision of internationalization of the US franchisors is often influenced by contact from the third parties (Walker and Etzel, 1973; Hackett, 1976; Walker and Cross; 1989). Instead of a proper and planned strategic internationalization campaign (Abell, 1991), most international franchisors move into international market as they are often approached by a potential partner. This is mostly evidenced by franchise expansions in Europe. However, as in the case of Australia, international franchisors are

often interested in the expansion of business overseas, when approached by an interested overseas potential franchisee (Welch, 1989).

2.4.2 Motives of International Franchisors to Emerging Markets

Whereas many developed countries such as the United States, Canada and sections of Western Europe are reaching domestic market saturation, there is plenty of scope for franchising to expand into emerging markets.

Martin (1988) examines franchise from an industry perspective and finds that capital needs, market competition, monitoring costs, and the need to reach minimum efficient scale were reasons for franchise.

Tannenbaum (1992) finds that one-third of U.S. franchisors have overseas operations. Among the firms without overseas operations, 50 percent indicate interest in operating overseas. While franchisors that are older and/or have a larger number of units are more likely to operate internationally (Huszagh, Huszagh, and McIntyre 1992), all types and sizes of franchisors are interested in becoming international franchisors (Aydin and Kacker 1990). Franchising as an organizational form is gaining acceptance in many countries (Preble and Hoffman 1995).

2.4.3 Motivation of International Franchising: Explanations Based on Agency Theory and Resource Scarcity Theory

2.4.3.1 The Concept of Agency Theory and Resource Scarcity Theory

Resource allocation theory and agency theory are the two most commonly employed explanations for franchising in domestic market (Oxenfeldt and Kelly, 1969; Ozanne and Hunt, 1971; Caves and Murphy, 1976; Rubin, 1978; Mathewson and Winter, 1985; Brickley and Dark, 1987).

The resource scarcity theory treats franchising system as an integration of resources both from the franchisee and from the franchisor. When a firm expands business, certain resources may be in short supply, and thus the firm may choose franchising in order to use the franchisees' resources. The resources a franchisee may provide include finance, managerial talent, low cost capital, simple entrepreneurial skills, lower labour costs, and local economies of scale (Norton, 1988). Most studies on franchising focus on capital requirement argument. For example, Hunt (1973, p.3-12) points out that: "firms often choose the route of franchised units because they simply do not have access to the capital required to expand via company-operated units". Justis and Judd (1998) argue that the reason is "to allow a business to expand with limited capital, limited risk, and equity investment, a franchisor does not have to inject large sums of money or incur major debt in order to expand the business into new locations". The most popular theoretical model is the life cycle model of franchising by Oxenfeldt and Kelly (1968). According to this model, a new company with a limited access to external funds will adopt franchising to use franchisee's capital. Then as it acquires sufficient capital, the franchisor will later take over the larger units from the franchisees. However, the capital scarcity argument faces several critics. Rubin (1978) argues that the franchisor is able to

reduce risk by investing in the entire system and hence has a lower cost of capital than the franchisee, making capital more available to the franchisor than to the franchisee. Unless there are imperfections in debt and stock markets, the franchisee's capital is less efficient financial source.

According to agency theory (Brickley and Dark 1987; Mathewson and Winter 1985; Rubin 1978), managers will tend to shirk their duty to the firm because their compensation is fixed, and thus the firm has to pay high costs to monitor its managers. Franchising contracts transfer the managers into owners of outlets and keep the financial interests of franchisors and franchisee closely aligned. Hence, franchisee-owned units are likely to perform better than company-owned units.

Both theories are supported by empirical studies of domestic franchising. For capital scarcity argument, Hunt (1973) finds an aggregate trend towards company-owned units in the fast-food industry. He also finds that larger and older units are likely to become company-owned units. Caves and Murphy (1976) also observe a similar trend towards company ownership in restaurants, hotels, and motels. Thompson (1994) finds that company ownership is less likely to occur when units require high capital investment or when the franchisor is experiencing significant growth, thereby supporting the notion that resource constraints drive the decision towards franchising.

2.4.3.2 International Franchising: Explanation Based on Agency Theory

For the explanation based on the agency theory, Brickley and Dark (1987) find that high employee monitoring costs, low initial investment cost per unit and high frequency of repeat customers per unit favoured franchising over company-owned units. Combs and Castrogiovanni (1994) find no support for the notion of resource scarcity but did find significant support for the agency theory and risk-spreading perspectives.

In empirical study of domestic franchising, the agency theory is found to be more important than capital scarcity argument. It was observed that many businesses who clearly have full access to capital markets also adopts franchising, and the franchisors did provide financial support to franchisees. To test the relative importance of these two theories in explaining franchising, Martin (1988) examines franchising from an industry perspective and finds that capital needs, market competition, monitoring costs, and the need to reach minimum efficient scale were reasons for franchise. Lafontaine's (1992) study supports both theories. He finds that franchising is prevalent when there are incentive problems, but firms also use franchising to overcome the resource constraint and grow faster. Thompson (1994) argues that managerial talent may be a scarcer resource than capital for a growing organization. Combs and Ketchen (1999) find that agency theory is the main explanation of franchising, and the capital scarcity provides additional explanation. The general

conclusion is that agency theory play dominant role in explaining franchising.

2.4.3.3 International Franchising: Explanation Based on Capital Scarcity

Several researchers argued that capital scarcity is not treated as an important reason for domestic franchising because franchisees are a costly source of capital (Rubin, 1990; Norton, 1995). When a firm needs external fund to expand the business, it is more efficient to obtain capital from debt and equity market. “Unless there are imperfections in debt and equity markets that might increase the cost of capital from passive investors, using franchise capital to delimit capital scarcity would be inefficient and irrational” (Combs and Ketchen, 1999, p196)

The capital market imperfections exist in global market where many countries’ financial systems are under-developed. The imperfections in debt and equity market of the host country limit the access to external fund through formal financial channels, especially for foreign firms. However, local franchisees are able to provide capital at low cost, through both formal and informal financial mechanisms. They may have significant advantage in information and relationship to acquiring external funds. Using franchisee’s capital to confine capital may be an important incentive for foreign firms to adopt franchising. Capital scarcity may come from both demand side and supply side. From demand side, the higher the initial investment cost is, the more likely the firm faces financial constraints.

From supply side, if a firm is able to obtain large volume of internal funds or access external funds at low cost, then the firm is less likely to use franchisee's capital.

2.5 Choice of Entry Modes for International Franchising Firms

2.5.1 Franchising as a Market Entry Mode

For firms interested in expanding their international markets, entry mode choice is a critical issue for those who decide to invest overseas, and has a great impact on the level of control of the company (Anderson and Gatignon, 1986; Agarwal and Ramaswami, 1992).

Pan and Tse, (2000) define the market entry mode as the institutional arrangement by which a firm get its products, technologies, human skills, or other resources into a market. Franchising entry modes have provided many good opportunities for multinational firms to expand to overseas markets with comparatively less resources and risks, so the international franchising entry modes have long intrigued many researchers (Chan and Justis, 1990; Justis and Judd, 1998). The most debated topic in franchising research is the reason why a firm chooses to franchise rather than expand through company-owned units. The following are widely used international franchising entry modes nowadays: master franchising and direct international franchising (Nair, 2001). There are some main types of ownership option open to companies entering new markets: joint venture, wholly-owned foreign enterprise, licensing and representative offices.

Research has found joint venture is the most popular mode of operation (Welch 1990; Goncalves and Duarte 1994). Chan and Justis (1990) suggest joint venture, direct investment, or governmental agreements as possible entry strategies for franchises trying to enter the East Asian market.

As Nair (2001) identifies that regardless of entry strategy the franchisor adopts (i.e. direct or other entry mode choice), it needs to establish a business presence in China.

2.5.2 International Franchising Market Entry Mode Choice

Until recently it was routinely assumed that international franchising was merely a replication of domestic franchising practices (Teegan, 2000). However, practically it is a much more complex process and franchisors should not expect to be able to transplant their systems to a foreign environment with only little modification. Several choices are available for entering overseas markets including direct franchising, master franchising, area development, joint venture arrangements and wholly foreign-owned subsidiaries (Chow, 1994; Petersen and Welch, 2000; Teegan, 2000).

Martin (1992) points out that there are a number of different approaches to international development which are common in use. These include: company-owned only operations; direct franchising; the establishment of a branch operation; the establishment of a subsidiary; the establishment of an area developer; the grant of master franchise rights and the entry into of

a joint venture.

The following are currently widely used entry modes for international franchising: (1) master franchising; (2) direct international franchising (Chan and Justis, 1990; Niu, 2001;;Justis and Judd, 1998). International franchising entry modes may provide good opportunities for firms to expand to overseas markets with comparatively less resources and risks. The international franchising entry modes have been well studied by many researchers (Chan and Justis, 1990; Niu , 2001; Justis and Judd, 1998). The following are widely used international franchising entry modes nowadays.

- (1) Direct international franchising
- (2) Master franchising
- (3) Equity joint venture
- (4) Cooperative joint venture
- (5) Wholly-owned foreign enterprises
- (6) Representative offices
- (7) Processing compensation trade venture
- (8) Technology licensing (Chan and Justis, 1990; Niu , 2001;Justis and Judd, 1998)

2.5.3 Direct Franchising

Under direct franchising, the franchisor negotiates with individual franchisees as is normally carried out under domestic franchising arrangements. The franchisors grant the franchising right directly to franchisees situated in host country without the intervention of a third party.

Using this direct franchising as the entry mode, the franchisors can totally control the system and trademarks, and in cases of a failure performance, they can terminate only one franchisee, not usually a major part of its franchise system. But using this mode, it may be difficult for the franchisors to service the franchise system properly as well as provide training to foreign franchisees from the franchisors' home location. Also, decision-making on matters that require rapid action may be difficult (Pei and Sun, 2004).

Niu (2001) points out that under direct international franchising, the franchisor establishes each individual franchising outlet and manages the resulting network in the foreign market directly -- i.e. without the use of any intervening organization. Many other researchers, for example, Justis and Judd (1998) also study this method. They agree that direct international franchising enables the franchisor to have a greater degree of control and allows both the franchisor and the franchisee to have larger profits because it eliminates third parties from the equation. However, direct international franchising has some disadvantage. The major problem of this kind of investment is the exposure of a large investor to many businesses and as well as political risks. Initial empirical support for this view was provided by Hunt (1973), who found an aggregate trend towards other entry mode choice in the fast-food industry. He also finds that larger and older units are likely to adopt other entry mode choice. Caves and Murphy (1976) also observed a similar trend towards joint venture in restaurants, hotels, and motels. Additional evidence was provided by Anderson (1984), who found

that the percentage of units owned by franchisors systematically increased over a period of ten years.

Thompson (1994) finds that other entry mode choice is less likely to occur when units require high capital investment or when the franchisor is experiencing significant growth, thereby supporting the notion that resource constraints drive the decision towards franchising. He also reports that other entry mode choice of units occurs in urban areas and areas where units tend to be large. The importance of resources for firms in the early stages of growth is also evidenced by new franchisors charging a higher initial fee than older franchisors (Sen 1993). However, Shelton (1967) points out that franchised units outperformed company-owned units, even though the managers of company-owned units receive some incentive compensation. According to franchisors, the high level of motivation of franchisees compared to paid employees is the most important advantage offered by franchising (Lillis, Narayana, and Gilman 1976). This may be a result of the franchisee having a marginal opportunity cost of labour below that of a hired employee (Caves and Murphy 1976).

2.5.4 Master Franchising

Master franchising introduces another level of ownership and management by allowing a master franchisee to sub-franchise the system to individual owner-operators. Again, a similar practice may be carried out in the domestic market. Chan and Justis (1990) describe that under this system, the franchisor grants a master franchise to a company to develop a country

or territory. The master franchisee will usually have sufficient resources to develop the territory and also have sufficient knowledge of local conditions. International franchisors should use master franchising when entering countries which have high culture difference and therefore with high-risks.

Nair (2001) describes that under this system, the franchisor grants a master franchise to a company to develop a country or territory. The master franchisee will usually have sufficient resources to develop the territory and also have sufficient knowledge of local conditions and of franchising concept.

Welsh, Alon and Falbe (2006) indicate that indirect franchising, that is, the use of a master franchisee to develop a territory or a whole country is a common strategy employed by franchisors in emerging markets. Nair (2001) noted that the advantages of this system include access to resources, knowledge of the local market, more adaptation, and the possibility of developing a successful franchise as a tool for selling to prospective franchisees. The indirect system also has disadvantages, including lower profits for franchisors and franchisees, and monitoring issues because of loss of control. There have been numerous examples of a master franchisee holding the sub-franchisees hostage to compete against the franchisor. Ultimately, success will be determined by the energy, capabilities, and resources of the master franchisee.

Alon and McKee (1999) suggest that International franchisors should use

indirect franchising when entering countries which have high culture difference and therefore with high-risks. The franchisor enters into a master franchise agreement directly with a master franchisee, and the master franchisee develops and owns franchise outlets in addition to sub-franchising outlets to sub-franchisees in the host country. The entrepreneurial skills of master franchisee can lower the operational cost and help in making faster decisions based on local conditions. However, business failure of the master franchisee will affect the entire franchise system and damage done to its reputation may be difficult to repair. Also, indirect franchising encounter the difficulty in enforcing terminations and other franchisors rights, and the franchisor may become locked into an unsatisfactory relationship.

Alon and McKee (1999) also suggest that the greater the cultural gap is there, the less willing the firm is to make large investments in ventures. The more willing is to enter into non-equity alliances, the more likely the franchisor is to use master franchising. Konigsberg (1990) also stresses the importance of partnerships in culturally unfamiliar environments. Those who are doing franchising can provide the global company with local knowledge.

2.5.5 Joint Venture

Relating to joint venture mode, Chan and Justis (1990) define joint venture as follows: ‘the franchisor seeks a form of partnership with a foreign franchisee in establishing franchise units’. They think joint venture mode is

more likely to be adapted when international franchisor entering a country where there is high contractual risk.

Joint ventures involve the creation of a separate legal entity in which outlets are jointly owned by the franchisor and a Chinese partner who is familiar with the local business environment.

2.5.6 Equity Joint Venture

Equity joint venture is limited liability corporations in which the host country partners and foreign partners jointly invest in cash and manage operations through a board of directors. Profits and losses are shared in proportion to the investment contributed by each partner. This is a popular form of cooperation. It is ideal for companies that possess technology and access to a market but either do not have large cash reserves or wish to limit their exposure (English, Martinez and Justis 1998).

2.5.7 Cooperative Joint Venture

Cooperative joint venture is very flexible and may take any form agreed between the domestic and foreign partners. In such a venture, both the domestic and foreign partners contribute. For instance, the domestic partner could contribute land and building and the foreign partner could contribute equipment and technology. Cooperative joint ventures (CJVs) are a suitable form of joint venture for projects like construction and management of hotels, commercial complexes, offshore oil drilling, etc. Much of the success of the venture depends upon the quality of the partner. If problems

arise with the partner, this type of venture will have a high risk of failure. Valuations of assets invested in the project could also create problems (Cateora and Graham 2002).

2.5.8 Wholly-owned Foreign Enterprises

Wholly-owned foreign enterprise is the most widely used entry method. Justis and Judd (1998) also describe wholly-owned subsidiary as franchisor invests in company-owned stores or subsidiaries in foreign markets. This means that the franchisor provides all the capital and resources necessary for starting up the foreign units. Justis and Judd (1998) also supposes that in the case of international franchising, a larger franchisor would like to select the entry mode of wholly-owned subsidiary.

Alternatively, a wholly foreign-owned enterprise may be established in the host country with the advantage of providing the franchisor with greater control over its intellectual property (China: Country Commercial Guide, 1999; Petersen and Welch, 2000).

Wholly owned foreign enterprises are also limited liability enterprises but the registered capital is entirely provided by the foreign investor. This is probably the best vehicle for a franchisor who has great awareness of the local market and the cash flow to manage operations until they become self-sustaining. In order to have full control, the foreign investor must have a good management team and have a good relationship with the various authorities, like customs, tax, etc.

2.5.9 Representative Offices

Representative offices are restricted to performing promotional and liaison functions. They are not allowed to conduct any profit-making business activities. Representative offices are subject to tax since many of them are, contrary to the regulations, engaged in actual business. Taxability depends largely on the nature of activities carried by the representative office and its head office (Bradley, 2002).

2.5.10 Processing Compensation Trade Venture

Compensation trade involves the transfer of machinery, equipment and/or technology from a foreign party to an enterprise, with payments being made in instalments only after production starts. This is more like a sale with deferred payments. The foreign entity does not have any stake in the company and has no say in the management. This type of venture has limited relevance to franchising (Kahler and Kramer, 1997).

2.5.11 Technology Licensing

Referring to technology licensing mode, Justis and Judd (1998) describe that the franchisor enters into a country and has an agreement with a license and offers franchisees the right to use a product, service, good, trademark, trade secret, patent, or other valuable item in return for a royalty fee. They argue that franchisee gains the extra knowledge and capability of the franchisor through using the licensing method. This method enables the franchisor to enter the target market with little risk or even no risk.

2.6 Some of the Key Factors Influencing Foreign Market

Entry Mode

Cateora and Graham (2002) point out that once a company makes the decision to enter foreign markets, it must choose an entry strategy properly. These strategic decisions can impact a firm's performance in the host country significantly. In terms of conceptualisation of the factors that influence international franchising intentions, Doherty (2007) points out that the work of Welch (1990) and Eroglu (1992) is significant. In addition to above research results, English and Justis (1999) also point out that Walker and Hackett also can be called the pioneer researchers of franchising entry mode. They made great efforts to examine the expansion of U.S.A based franchisors and their future plans. Welch (1990) categorises the factors influencing franchise internationalization as background factors, direct stimuli and decision-maker characteristics. Doherty (2007) concludes that based on the work by Weidersheim, Olson and Welch (1978) from the international marketing literature, background factors are not seen to directly relate to international entry, but it strengthens the likelihood of exposure to international possibilities and pressures. Doherty (2007) further points out that although Welch (1990) acknowledges that the background factors seem to set up the foundation for internationalisation, it is the internal and external direct stimuli, identified as fortuitous franchisee interest and domestic saturation, caused to a more direct interest for firms to move overseas. Welch (1990) acknowledges that international franchisors in most cases expanding business overseas develops the as a result of a combination of factors interacting with the background factors and decision maker characteristics. He also notes that it is difficult to

analyse the international franchising entry process because there is often not a ready observable path which leads to franchising.

Based on previous studies, this section attempts to identify some key factors that may influence foreign market entry mode.

2.6.1 Classification of Factors for International Franchising Entry Mode Choice

Koch (2001) investigates a number of entry mode determinants, and classifies them into three broad categories: 1) external factors; 2) internal factors; 3) mixed factors. Subdividing these factors, there are three main parts: 1) host country-specific factors; 2) home country-specific factors; 3) industry-specific factors.

A recent study (Tes and Pan ,1997) confirms that operation-related factor (like entry location) also affects the a firm's market entry selection.

A macro environmental model of franchising in the international context has been proposed and four key factors important to country analysis have been identified. These include:

- (1) Economic variables;
- (2) Demographic variables;
- (3) Distance variables;
- (4) Political variables.

Those influences of franchising in an international market with distance represent two aspects—physical and cultural (Alon Toncar and Mckee 2000).

Welch (1992) considers the following factors that may determine franchise internationalization:

- (1) Background factors (including network spread; expansion ethos; learning process);
- (2) Direct stimuli (including fortuitous franchisee interest; domestic saturation); (3) Decision-maker characteristics (including values; attitude; experience; knowledge).

Koch (2001) classifies all factors proposed to influence the foreign market strategy fall into three broad categories: (1) external factors; (2) internal factors and (3) mixed factors.

Agarwal and Ramaswami (1992) confirm that ownership-specific factors (e.g. ability to develop differentiated products), location factors (e.g. market potential) and internalization factors (e.g. contractual risks) significantly affect multinational enterprises' entry mode.

Sashi and Karuppur (2001) develop a conceptual framework of international franchising, mainly based on the transaction cost analysis and agency theory. In their framework, the likelihood of adopting franchising in global market relies on four sets of factors:

- 1) Firm-specific assets, which include brand name and technical knowledge;
 - 2) External uncertainty, which includes political uncertainty, economic uncertainty and currency uncertainty;
 - 3) Internal uncertainty, which includes cultural distance, geographic distance and global experience;
 - 4) Type of product, which include local value addition, initial investment cost, capital requirements, and technological change. However, they did not provide the empirical evidences supporting this conceptual framework.
- Combs and Ketchen (1999) explain the franchising based on both agency theory and capital scarcity. Based on the agency theory, the likelihood of expanding through franchising depends on the costs of direct monitoring, the firms' specific knowledge, and asset specificity.

Physical distance was one of most mentioned factor in US international franchising expansion. This is why most US based franchisors planning international franchises chose Canada as the first site of international expansion followed by Mexico. Fladmoe-Lindquist (1996) posed the problem of physical distance from the standpoint of administrative efficiency theory. Physical distance makes monitoring difficult and expensive. Communication technology is not perfectly standardized across and among countries because of regulations regarding transmission. Cultural distance refers to the difference in the cultural and language of the host and home countries. Difference in values and methods including the use of language influence the success of home international franchisors.

2.6.2 Host Country's Environmental Factors

Although past research shows that the desire for internationalization is often motivated by a third party, a franchisor or a foreign nation (Welch, 1992), franchisors should analyze the environment of a host country in order to evaluate the receptivity of the franchise system. Environmental factors have high research value to international franchisors in choosing a host country for expansion (Alon and McKee 1999). A number of previous studies (e.g., Dunning 1988; Brouthers, Lance and Werner 1996) have confirmed the value of country-specific factors.

As for the environmental factor, Litvak and Banting (1968) concern the relationship of U.S. companies' entry strategies into foreign country markets and those countries' positions along an environmental "temperature gradient". In order to explain this theory, they outlined the following hypothesis: A firm will tend to adopt an entry strategy involving greater control over and greater investment in marketing channel activities as the country's environment becomes hotter in "Litvak-Banting sense". "Hot" countries are defined as the countries that are politically stable.

Scholars such as Goodnow and Hansz (1971) examine this hypothesis and provide supportive evidence for the Litvak-Banting hypothesis. For instance, they find many firms substitute direct export for local manufacturing while moving from "Hot" to "Cold" country clusters. These firms move away from the use of licensees and joint venture partners while they make significantly greater use of strategies involving overseas agents

and distributors.

The findings generally support the Litvak-Banting hypothesis that the extent of investment as well as the degree of control exercised by parent firms over distribution channels in other countries is related to the external environment and that the extent of investment and degree of control declines as the environment becomes less favourable (Goodnow and Hansz, 1971). They conclude that external environment not only influences channel selection, but also influences whether a firm chooses to enter a market.

Osland and Cavusgil (1996) remarks that the above factors are influenced by host country-specific factor and industry factors. The host country-specific factors include country risk and location familiarity (Hill, Hwang and Kim, 1990).

A number of previous studies have noted the importance of distance factors. The distance dimension consists of physical distance and cultural distance (Eroglu, 1992). Physical distance is one of most mentioned factor in US international franchising expansion. This is why most US-based franchisors choose Canada and Mexico as the destination of international expansion. Cultural distance refers to the difference in the cultural and language of the host and home countries. Difference in values and methods influence the success of international franchisors.

Eroglu's (1992) conceptual model of international franchising process also focuses on the reasons why franchising firms have the intention to move into overseas markets. He identifies organisational factors and environmental factors influencing franchising firm's international decisions. Organisational factors are found to be firm size, operating experience, top manager's international experience, tolerance for risk and perception of the firm's competitive advantage. External environmental factors include domestic competitive pressure, external change agent influence and perceived favourability of the external environment.

Cultural diversity between the franchisor and host country, particularly as regards value and method, can create internal uncertainty as well as problems in business conduct (Anderson and Gatigon, 1986). The original study by Hofstede (1980) confirms that national culture gap, particularly Western culture and Eastern culture difference sharply affects an organisation's management. Building on Hofstede's theory, a few studies verify that home country culture has a great impact on a firm's business activities abroad (Tes and Pan, 1997; Taylor, Zhou and Gregory, 2000; Koch, 2001).

Tes and Pan (1997) conclude that two culture dimensions (i.e., power distance and uncertainty avoidance) largely affect market entry mode choices. They state that firms with more distant culture prefer to choose equity-based entry mode while firms from the lower uncertainty avoidance cultural countries are more likely to choose the low cost entry modes to

avoid risks. Since East Asian society has different institutional structure than Western nations (Taylor, Zhou and Gregory, 2000), when East Asian firms enter overseas markets, culture gap is a considerable factor in weighting foreign market entry decision. One good example is Chinese Guanxi culture (network of personal connections). Guanxi is embodied in friendship and affection. In context of Chinese business, with strong Guanxi network with powerful persons or government, firms dare to take risk, in other words, they will choose high level control investment abroad. Social culture distance between home country and host country discourages company from choosing wholly-owned entry mode (Sun, 1999).

The differences in management orientation naturally follow the cultural differences. Business people in US and Europe value individualism seek risks and want to get the heart of the matter in the shortest time, while Chinese business people are inclined to indirect display of a collectivist attitude and try to avoid various risks (Jagersma and Gorp ,2003). Hofstede (1980) believes that the welfare of the business goes before the group's best interests in west and, conversely, the respect for the group goes without exception before business in China.

Accordingly, the first hypothesis can be developed:

H1: The more the culture and geographical distance between the host country and home country, the less likely the international franchisor is to adopt direct franchising entry mode in China.

2.6.3 International Business Experience

Previous studies have asserted that accumulated international business experience can help international franchising firms shorten their perceived distance between the home and host markets. It is clarified that when firms first enter a country which is culturally different from home country, they tend to be reluctant to adopt foreign direct investment. Once the barriers of language and culture are overcome, however, the likelihood of foreign direct investment increases (Johanson and Vahlne, 1977; Kim and Hwang, 1992). International business experience has been recognized as important factor that may affect a firm's entry mode. Anderson and Gatignon (1986) indicate that a firm's international experience has positive correlation to high-level control model. The more international experience a firm possesses, the more likely the firm adopts an entry mode with higher level of control. This finding is supported by other researchers (Herrman and Datta, 2002).

Franchising firms like McDonald's would like to use their rich experience to develop business in similar markets. Shama (1995) finds that relatively positive experiences of U.S. companies aiming to enter global market plays a very important role in developing Eastern European countries. It is expected that those international franchising firms with a limited amount of international business experience are more likely to adopt other entry mode choice in China.

The empirical evidences of the effect of international experience on firm's entry mode are mixed. On one hand, several empirical studies found that

international experience significantly affect the firm's entry mode. For example, in literature chapter, Anderson and Gatignon (1986) and Herrman and Datta, (2002) found that the more international experience a firm possesses, the more likely the firm is to adopt an entry mode with higher level of control. Whitelock (2002) also predicates that international experiential knowledge is a kind of considerable factor in international marketing. On the other hand, several studies show that international experience has no significant impact on marketing strategy. For example, Kogut (1988) finds that a firm's international experience is not instrumental in its market expansion decisions, Based on Hong Kong SME's entering the mainland China, Shi, Ho and Siu (2001) indicated that international experience does not seem to affect the market strategy.

Hence, the following hypothesis is conducted:

H2: The richer the experience of international franchisors, the more likely the firms is to adopt direct franchising entry mode in China.

2.6.4 International Franchising System Developing Stage

Common sense tells that higher competitive pressures in the home market encourage a company to explore international markets so that it can avoid domestic risk and hence obtain greater perceived benefit. As the product reaches maturity stage, a firm begins to explore international market (Janson and Vahlne 1990). Carney and Gedajlovic (1991) attempt to synthesize the resource scarcity theories and agency theories. Based on a study of franchising patterns in Quebec, they developed a path model of the franchising life cycle that incorporates these two theories. Similar

findings were reported by Lafontaine (1992). She finds that franchising is prevalent when there are incentive problems, but firms also use franchising to grow faster, though the constraints that franchising must overcome may not only be limited to financial problems.

Li (2000) believes that Chinese market is not as mature as western countries'. Then he suggests that two difficulties should be noted: first, the Chinese political/economic system is still substantially central authorities; second, accuracy of data remains a problem.

One of the most popular theoretical models is the life cycle model of franchising by Oxenfelt and Kelly (1968). According to this model, a new company with a limited access to external funds will adopt other entry mode choice to use franchisee's capital. Then as it acquires sufficient capital, the franchisor will later take over the larger units from the franchisees or will adopt direct franchising. This conclusion is just based on the developed countries. The author doubts about it and wants to test if it is the case in China.

This leads to the following hypothesis:

H3: The higher the rate of the expansion of the franchising system, the more likely the firms is to adopt direct franchising entry mode in China.

2.6.5 International Franchising System Life Cycle

From the point of franchiser or the general operation condition of

franchising, Lillis, Narayana, and Gilman (1976) divide the franchising system life cycle into four stages: penetration, growth, maturity and late maturity. Based on franchisers' operation years and outlet number, the authors classify international franchising system life cycle as follows:

Table 2.1 The franchising life cycle

| Stage | Operation years | Outlet number |
|---------------|-----------------|---------------|
| Penetration | 0-5 | 0-10 |
| Expansion | 6-8 | 11 or more |
| Maturity | 9-13 | 30 or more |
| Late maturity | Over 14 | 50 or more |

Source: Charles M. Lillis, Chem L. Narayana and John L. Gilman, "Competitive advantage variation over the life cycle of a franchise", *Journal of Marketing*, 1976, 40 (October): pp77-80

As indicated in Table 2.1, companies at the stage of penetration normally have operation experience of no more than 5 years. The number of outlets is limited, possibly due to constraints in capital, experience and credits in the market. Another possible interpretation is that establishment of an outlet is time-consuming. As the companies enter the expansion and maturity stage, the number of outlets increases sharply, and peaks at the late maturity stage.

There is a learning curve for foreign investors in host countries (Casseres, 1990). During the early stages of operations, a foreign firm normally requires a local partner. With experience, a MNC will capture more local knowledge and learning, and hence acquire better organizational capabilities. This would then suggest a reduced dependency on the local partners (Niu, 2001). Some studies also confirm that MNCs with more

experience in a particular country tend to expand by means of full control mode, as befitting their overall strategic position (Agarwal and Ramaswami, 1992). Indeed, many foreign logistics firms in Asia initially operate as partial control mode. After some time, with greater host country experience, they take over the assets from the local partners and operate as direct franchising. This conclusion is also based on the experience in USA. Therefore the author wants to test if it is the same in the China market. Then this leads to the following hypothesis:

H4: The more mature the international franchising system, the more likely the firms are to adopt direct franchising entry mode in China.

2.6.6 International Franchising Firm's Attitude toward Risk Spreading

Risk spreading is an important explanation for franchising. Franchising allows a risk-averse franchisor to maintain control over profitable units with more certain revenue patterns while ridding "risky" location with uncertain and unpredictable revenues. (James and Gary, 2003) It is assumed that risk-averse franchisors sell franchises to risk neutral franchisees. However, Martin (1988) points out franchisees have already chosen a low-risk path by embracing franchising over independent business ownership. Furthermore, franchisees have been shown to have significantly lower failure than independent business (Anderson, 1984; Gastrogiovanni, Justis and Julian, 1993). In addition, Martin (1988) observes that risk spreading is related to agency, because increased risk raises agency costs.

Faced with rapid technological advances, changing market structures and

increasing global competition, firms are motivated to form alliances with other firms to minimize operation and investment risks (Harriagn, 1988). Reasons for a firm to form an alliance with another firm may lie in resource pooling, asset protecting and the ability to react quickly to market changes, but the key reason is risk sharing. International franchisors that would like to enter overseas markets ought to learn the framework of government because the governmental factor is more significant for operations in host country than in other market economics as different level governments represent different risks to the investing firms. (Grow, 1986).

In China, there is a clear hierarchical government comprising the state government, the provincial and the municipal governments. In general, the higher level of the government, the less risky to invest (Zhan, 1993). It is believed that higher level governments have more authorities in scrutinizing and approving franchising projects in China.

As for the franchising risk, David, Pan and Kevin (1997) remark that the more risk-averse the home culture is, the more likely the investing firms would locate in lower risk areas. In China, one can expect that open coastal cities and Special Economic Zones (SEZs) are associated with low risks. Location-specific conditions vary substantially across China. There are so much regional segmentation and protectionism that foreign investors view China as several distinct markets (Jiang and Prater 2002). Government policies differ significantly across regions. A series of preferential policies towards FDI has been instituted since 1978. Prior to 1984, foreign

investment activities were limited to four Special Economic Zones, locating mainly in the Pearl River Delta. This was relaxed in 1984 to include 14 Open Coastal Cities. In addition, some cities were allowed to set up free trade zones (FTZs) to attract investment. Incentives such as tax reduction ease in market entry and land use were instituted for FDI in these cities. Moreover, as the coastal areas are normally commercial and industrial centres, they attract the most FDI in China and have better infrastructure. As foreign firms find it less risky to operate and more able to share the spill over from agglomeration economies in these areas, they are more likely to choose the full-control mode of wholly- owned foreign enterprise (WOFEs).

Among the most important transitional elements with respect to international investors are the political and economic risks that are introduced by the reorganization of economic and political units in emerging marketplaces (Czinkota and Ronkainen 1997). Such risks are systematically evaluated by western institutions such as the Economist Intelligence Unit, Institutional Investor, and International Country Risk Guide (ICRG). The ICRG is a business-venture risk rating system, whereby a certain value is attached to a foreign country by an independent collaborative group after many determining factors are evaluated and weighed.

Market governance influences a wide range of country risk elements such as government regulation and red tape, political stability, bribery,

ownership restrictions, controls of capital flows, and import restrictions. All these factors are important to international franchisors' evaluation of foreign market potential and essential to determinations of franchise expansion in the international retail arena (Alon and McKee 1999).

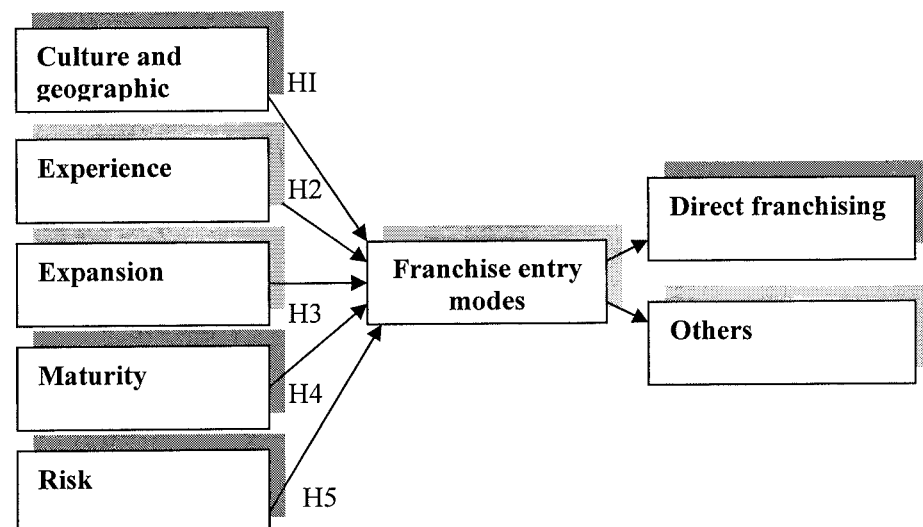
Hence, this leads the following hypothesis:

H5: The more consideration of risk spreading, the more likely the firms is to adopt direct franchising entry mode in China.

2.7 Chapter Summary

In summary, existing literature expounds that decision-making on foreign market strategic entry is a very complicated social process. It involves a variety of individual and organizational behaviours and is influenced by different elements. Intensive studies have been carried out on an international franchising basis. Based on existing literature, 5 hypotheses were finally developed. The author summarized these five hypotheses in Figure 2.1.

Figure 2.1: Summary of hypothesis



In the next chapter, the characteristics of franchising in China are to be elucidated.

Chapter 3

Characteristics of International Franchising in the Chinese Market

3.1 Introduction

This chapter will focus on the reasons for studying international franchising in China, and then it will focus on the development of franchising in China in order to strengthen the research topic.

3.2 The China Market

China has the world's largest potential market of 1.3 billion people (Sheppard, 1999), including 850 million Chinese below the age of 35 (Zeidman, 2000). In addition to the size of the market, Chinese people are now enjoying rapidly rising levels of disposable income particularly in urban areas which have likewise faced impressive economic growth (Sheppard, 1999). The last decade has seen a surge of interest by retail franchising systems wishing to enter China. Previously the nation was dominated by a state-controlled distribution system with stringent restrictions on foreign entry but the Chinese government introduced franchising regulation in 1997 and the concept is now actively encouraged as a means of promoting economic development (Preble, 1992; Tomzack, 1995; Zeidman, 2000). In particular, following the Asian economic crisis, it appears that the Chinese government is encouraging business growth in

the retail and service sectors to bolster employment and competition (Sheppard, 1999; Teegan, 2000).

Early entrants into the newly opened China have been large United States' franchisors such as McDonald's, KFC and Subway. The fast food industry has been responsible for most of the growth in franchising in China (China: Country Commercial Guide, 1999; Zeidman, 2000), possibly due to an increased demand for imported products (Teegan, 2000) and a growing interest in western lifestyles. As Nair (2004) summarizes that franchising in China has a lot of advantages. Franchising allows for rapid expansion into this vast and virgin market with relatively modest capital by leveraging the resources and knowledge of the franchisees instead of relying exclusively on the resources of the franchisor. Franchising allows the franchisor to use the experience, contacts, and connections of the franchisee rather than having to reinvent the wheel by learning the local customs and market place. In a country where contact and connections often make or break a business, this is an invaluable asset. Typically, the franchising contract includes complete training for the local franchisee. This enables the franchisee to learn about a time-tested (albeit in a totally different setting) process and procedure. This aspect is very important because the franchisee may have no knowledge whatsoever of business norms and of concepts of customer service. It is equally important for the franchisor to be aware that the process and procedures they have developed may need to be modified to adapt to ground realities in the host country. Franchising promotes a consistently high quality of service in a

country where people are only just beginning to realize that the customer is king. Franchising would allow the franchisor/foreign investor to indirectly benefit from retail markets that would otherwise be off-limits to foreign investors. Franchising provides a social benefit with its potential to provide employment. With the break up of the “iron rice bowl” (the quintessentially Communist system of state-guaranteed job and housing from the cradle to the grave), unemployment is rampant. Thus, any activity with the potential to create additional jobs is likely be welcomed by the state.

3.3 The Development of International Franchising in China

3.3.1 Overview of International Franchising in China

Franchising as a method of business operation was introduced to China by KFC in the late 1980s in an environment which was by then increasingly receptive to foreign investment and western concepts under Deng Xiaoping’s economic reforms and open policies. Since the introduction of franchise regulation in 1997, the Chinese franchising sector has grown rapidly through its adoption by both international and domestic franchising companies. With 2300 franchise systems, China is already the largest country in the world in terms of franchising systems, although the scale of operations is still very limited from both per capita and percentage of GDP perspectives. Wang (2005) points out that franchising account for only 3 percent of China’s retail sales compared to 40 percent in US. Systems average 43 outlets in China compared to 540 outlets in the US (Guo, 2005).

Since China re-engaged with the international community and commenced a massive economic reform program in the late 1970s, its economic development has been remarkable with an average annual growth rate of over 9 percent (China National Bureau of Statistics, 2005). With its rapid economic growth and its 1.3 billion increasingly wealthy populations, China is one of the largest markets in the world. These factors, in combination with a relatively stable political environment, have made China the most popular destination in the world for foreign direct investment (Welsh and Alon, 2001).

3.3.2 Market Development of Fast Food Industry in China

China's nearly two-decade high economic growth, its open-up and the improvement of the people's lifestyles and the changing of rhythm of daily life have driven the rapidly rising demand for consumption of fast food and it has become one of the most important parts of the food and beverage industry in China. Since 1991, the country's consumption of fast food has grown 23.2 percent annually. By the end of 1996, there are about 800 professional fast food enterprises all over the country, with more than 4000 chain operation enterprises, and nearly 400000 fast food restaurants. The revenues of fast food reached RMB135.2 billion Yuan in 2001. Along with the improvement in overall living standards, not only in more developed regions, but also in less developed and low-income areas the total revenues of fast food is expected to increase 26.1 percent annually to RMB 431.597 billion Yuan by the year 2006 and it will advance to RMB

1,322.487.3 billion Yuan by the end of 2011, increasing by 25.1 percent per annum (Wood, 2005).

Development of fast food industry in China is not the same between the more sophisticated regions as such Beijing, Shanghai and other coast line cities versus the relatively less-developed regions in the central and the west. The more sophisticated regions, with an enhanced economy, catch much more attention from fast food investors than the less-developed regions. Shanghai-the economic and financial centre of China-is especially regarded as the most important city for the fast food industry. Shanghai's history has provided it with ample opportunity to adapt itself to the western world. (Xiao, 2005).

Fast food is in high demand by Chinese consumers because of their busy city life style - white-collar workers in particular enjoy chicken, hamburger, pizza or other fast food. Along with fast economic growth in China, the popular American fast food chains such as KFC and McDonald's have become a huge success story. They are the two major competitors.

Fast-food restaurants with strong brand name images, such as McDonalds and Kentucky Fried Chicken ('KFC'), are more popular than Chinese-style fast-foods because they are known for quality control and good store management. KFC and McDonald's are also known as the most active and prominent fast food companies in China. In spite of the competition between the two companies, they have been occupying the largest market share and enjoying great profits in China (KFC reached US\$241 million in sales in 2000, ranking on top of the China fast food list).(Xiao, 2005).

3.3.3 International franchising Pioneers in China

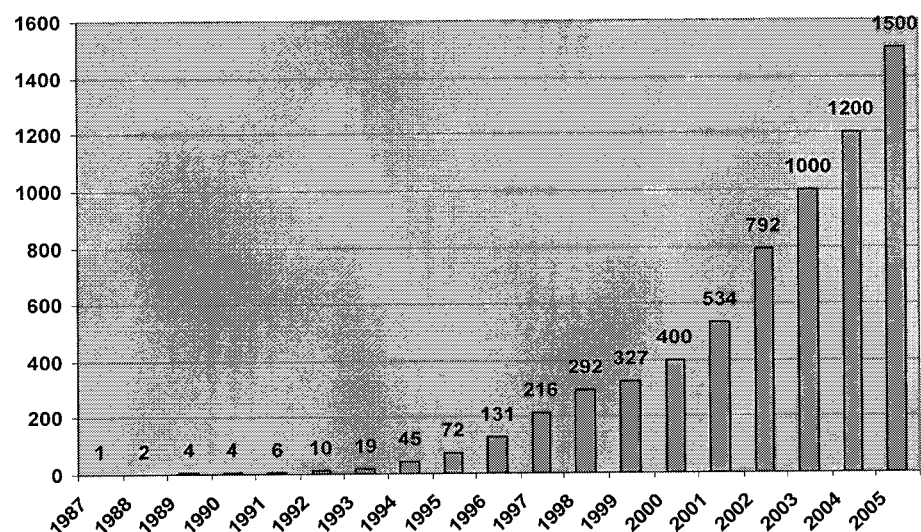
Franchising has thrived in this environment, but until franchise pioneers KFC and McDonald's began operations in China, the word "franchise" was not a part of the Chinese language. Ironically, despite introducing China to the franchising concept, these fast food pioneers did not initially use franchising to expand their businesses and, even today operate primarily through directly owned and managed "chain" operations (Terry and Wang 2005). In 1997 the Government promulgated China's first franchising regulation which not only provided a basic framework for the operation of franchising but also facilitated its growth. China's increasing engagement in the global community, together with its accession to the WTO in 2001, has also influenced the development of franchising in China through the liberalization of foreign investment in the franchise sector.

If the entry of KFC in 1987 is taken as the first contact China had with franchising, its development can be divided into several stages. The first stage was the introduction of the franchise concept by the US fast food pioneers (1987-1992). The second stage was the adoption of franchising by local enterprises (1992-1997). The third stage was the rapid growth of franchising which has been accompanied by predictable problems (1997-now) (Wang, 2004).

Franchising as a method of doing business is a US invention and was introduced to China in the same way it was introduced to other countries - by the international expansion of US franchise enterprises, particularly the

fast food systems. English and Xau (2001) record that KFC was the first major US fast-food franchise company to enter China. In February 1986, after almost three years of negotiations with government agencies, it entered into a joint venture contract with two state owned enterprises – Beijing Corporation of Production and Processing and Beijing Travel and Tourism Corporation. On November 12, 1987, KFC opened its first outlet in Beijing. Its distinctive outlet and its distinctive product attracted massive consumer interest. The opening day of the 650 seat Beijing restaurant was a great success breaking KFC world sales records. Its initial success led to its rapid expansion throughout China. By mid 1996, KFC had 100 outlets; today it has over 1,500 outlets in more than 260 cities. KFC's expansion is outlined in Figure3.1.

Figure 3. 1 KFC's expansion

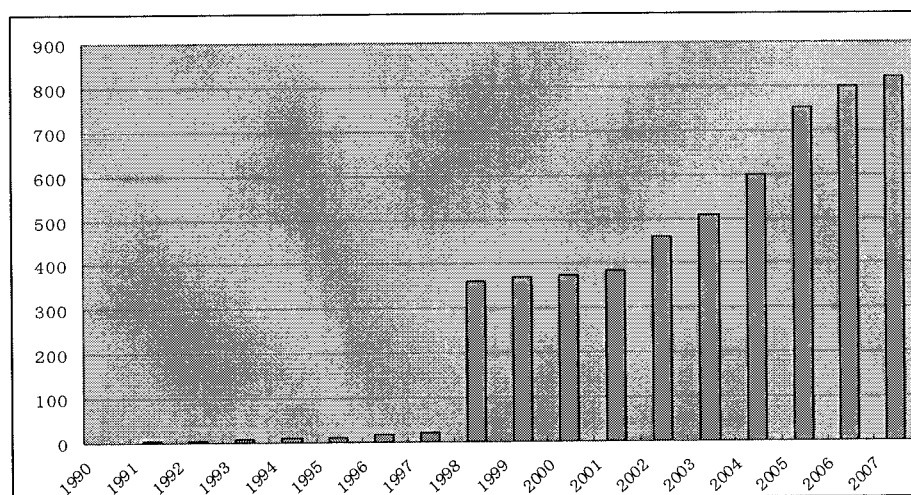


Source: http://www.kfc.com.cn/kfccda/aboutus/index_China.aspx

McDonald's was a later entrant into the Chinese market opening its first

outlet in 1990 in a joint venture with Beijing Corporation of Farming Industry and Commerce. Although it first adopted a similar strategy to KFC in establishing a joint venture with a state owned enterprise, it began its operation not in the national capital but in Shenzhen in the south of China, one of the first Special Economic Zones established following Deng Xiaoping's Open Policy to experiment with foreign investment. McDonald's soon moved to Beijing and in April 1992 opened an outlet in Wangfujin (the major shopping street of Beijing) which is still the largest in its 30,000 plus worldwide chain. Today, McDonald's has than 750 outlets McDonald's expansion is outlined in Figure3.2..

Figure 3.2 McDonald's expansion



Source: <http://www.ccfa.org.cn>

Since then, other international franchise companies have commenced operations in China. Pizza Hut and hotel chains Marriott and Holiday Inn entered China in the early 1990s. Century 21 appointed its first master franchisee in 2000 and has expanded rapidly. It now has 500 outlets with

5,000 brokers and US\$1.21 billion annual turnover. 7-eleven, Carlson Wagonlit Travel, Coldwell Banker Real Estate, Subway, Taco Bell, Domino's Pizza, Sheraton, and others are established in China. Burger King, a more recent entrant having opened its first restaurant in Shanghai in 2005, plans to have 1,000 restaurants in China within a decade (Desutter, 2005). Today, of the world's top 20 franchise chains in terms of worldwide sales (CCFA, 2005), 15 are in China.

3.3.4 The Entry Mode of Choices of Current International Franchisors in China

Although the entry of internationally prominent US franchise systems introduced the concept of franchising to China, their operations currently are primarily through other entry mode choice rather than direct franchising. For example, of KFC's 1,500 outlets only 54 are directly franchised – a small but nevertheless much greater proportion than for McDonald's which currently has only one directly franchised outlet in its 740 restaurants network. Zhou (2005) reported that McDonald's nevertheless plans to commence a direct franchising strategy outside the major cities. Because of a combination of regulatory, commercial and cultural factors, international franchising companies have established joint ventures with local companies, and for similar reasons, have expanded their operations through master franchising rather than through direct international franchising.

3.4 Adoption of Franchising by Local Enterprises

The success of the US fast food companies alerted the local business community to the unique advantages of the franchising concept and encouraged its adoption by local entrepreneurs. Li (2000) points out that the first Chinese enterprise to franchise its operations is reputed to be Lining Corporation, a sportswear company established in 1990 by Li Ning – a sporting legend, who won three gold medals in gymnastics of the 1984 Olympics. Li Ning expanded his business from 1993 through franchising, and soon created another legend by developing his system throughout the country.

Another early entrant was the Quanjude Group which was established in 1993 to take over Quanjude - the oldest and most famous Peking duck restaurant in Beijing which originally commenced operation in 1864. The Quanjude Group quickly adopted franchising to expand its operations, and it currently has more than 60 stores of which 37 are franchised. It is one of the few Chinese franchise companies that has franchised outside China with restaurants in the US and Japan and a proposal to open in Chinatown in Sydney, Australia (China Chain Store and Franchise Association, 2005)

Lining has become the leading domestic sportswear company and has been a franchising role model for private enterprises. Quanjude has become a role model for anachronistic state owned enterprises diversifying, reviving, and re-establishing their relevance. Encouraged by their successes, many other local enterprises have started to franchise, including supermarket chains Hualian and Lianhua, leisure restaurant Donglaishun, dry cleaning

chain Rongchang, and Chinese style fast food chain Malan Noodle. (CCFA,2005).

These successful domestic franchisors have led to the wider adoption of franchising by local enterprises.

3.5 Rapid Growth

The high profile and success of foreign systems, such as KFC and McDonald's, and local systems such as Lining and Quanjude, led many Chinese entrepreneurs to believe that franchising was a good product distribution channel. Enterprises traded off the proven success of franchising to promote their franchise systems and their consulting services. Slogans such as "to be the McDonald's of China", "the 10,000 stores project" and "boss making factory" were frequently used. Guo (1999) notes that franchising as a business strategy was widely utilized in expanding industry sectors but was practiced by many franchisors, franchisees and consultants without a comprehensive understanding of franchising or an appreciation of the factors on which its success had been built.

A 1995 speech made by former Premier Li Peng addressed the need for the healthy development of franchising to protect franchisees was the first signal that the Government was interested in the orderly development of the sector. It was soon followed by China's first official acknowledgment of franchising in the 1997, the Opinion on Regularizing the Operation and Management of Chain Stores which defined three forms of chain stores

including the “franchise chain” and the 1997 Administrative Measures for Franchising Operation (Trial Implementation) (hereinafter the 1997 Franchise Measures) which defined franchising for the first time in Chinese law and set out an elementary set of administrative rules for its operation. The Opinion on Regularizing the Operation and Management of Chain Store was issued by the Ministry of Internal Trade on the 27th of March, 1997.

The regulatory implications of the 1997 Franchise Measures were obviously significant but their greatest impact has perhaps been through communicating the Government’s support for franchising concept and encouragement of its adoption. 1997 is also significant as in that year the China Chain Store and Franchise Association (CCFA) was approved and registered by the Ministry of Civil Affairs to formulate trade regulations and to provide services to both franchisors and franchisees.

Although China has recently emerged as the leader in the world in terms of the number of franchise systems, the economic impact of the Chinese franchise sector is still at an embryonic stage. There is a massive potential for future growth as franchising business currently accounts for only 3 percent of China’s total retail sales, starkly 40 percent behind the United States (Guo, 2005).

Franchising as a method of business operation in China today is used by both local and foreign companies to access a wide range of industry sectors.

Businesses in diverse sectors have used franchising to expand their operations. Currently in Beijing there are 70 types of industries in chain store businesses of which over 40 have utilized franchising. Due to the increased pressures in the workplace and the need for leisure activities there are increased demands on time, and home services are becoming increasingly popular. Franchise systems have quickly responded to this niche. The figure below shows that fast food restaurants, retail, and household services are currently the three most popular areas for new franchise segments in China.

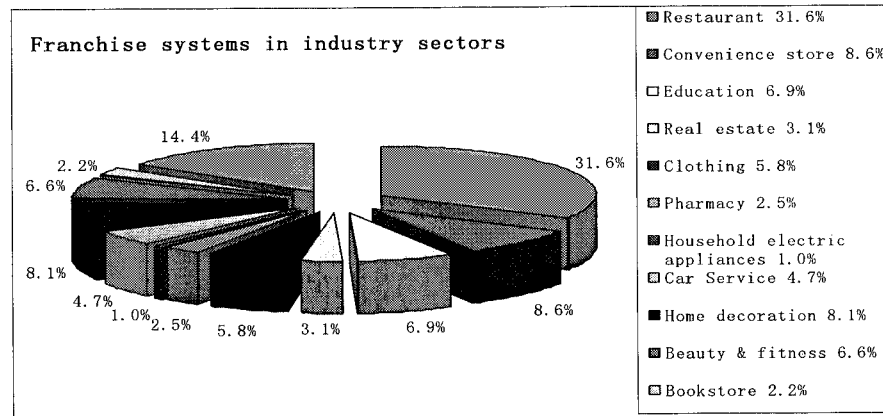
Table 3. 1 Average Annual Growth of Franchising Outlets and Turnover

| Sectors | | Average Annual Growth of Outlets percent | | Average Annual Growth of Turnover percent | |
|---------|---------------------|--|-------------|---|-------------|
| | | Franchisors | Franchisees | Franchisors | Franchisees |
| 1 | Real Estate | 75.48 | 79.06 | 150 | 190 |
| 2 | Home Decoration | 48.7 | 85.2 | 58 | 62 |
| 3 | Education | 31.2 | 41.8 | 30.2 | 30.5 |
| 4 | Bookstores | 8.51 | 7.43 | 8.12 | 7.28 |
| 5 | Laundry | 24.81 | 21.43 | 46.43 | 45.66 |
| 6 | Chinese Restaurants | 34.72 | 37.92 | 27.28 | 24.59 |
| 7 | Clothing | 18.07 | 15.54 | 26.19 | 28.22 |
| Average | | 33.18 | 37.87 | 33.94 | 40.15 |

Source: The 2005 Blue Book Report of Franchising and Chain Performance in China

Although franchise systems in China account for only a small percentage of retail sales, their sales growth has been extremely rapid. The sales growth of the franchise sector has averaged 40 per cent over the last few years, far greater than the 10 percent annual growth rate for national consumer sales (Bian and Ilan, 2003). However, the growth rates of various industries are different. We can see it from Figure 3.3.

Figure 3.3 Distribution of franchise systems in industry sectors (CCFA, 2006)



3.6 The Development of Increasing Franchising Expertise

The introduction of international franchise brands and the emergence of local franchise enterprises have led to the development of increasing franchising expertise. Chinese franchising is increasingly characterized by growing maturity in the organization of the wider sector. The government promotes franchising in different ways, including supporting the CCFA in its exhibitions and data collection. The CCFA has hosted the National Franchise Conference and Expo in Beijing annually since 1999 and the International Franchise Forum and Expo in Shanghai annually since 2002. The CCFA has also played an important role in education and obtaining statistical data. Zhu and Li (2004) claim that exhibitions held by national and provincial industry associations and private sector companies have increased to more than three per month on average, and these have grown each year in terms of franchise brands marketing their systems, potential investors and attendees. Academics have been attracted by the booming franchise sector as a significant research field. The International Franchise

Academy of Beijing Normal University in Zhuhai, the University of International Business and Economics, and China University of Political Science and Law have played a leading role in sector research. These and other universities offer courses in franchising and the International Franchise Academy offers a dedicated four year franchising degree, believed to be the first such initiative in the world. Books, magazines, and websites devoted to franchise have increasingly appeared and the sector is now the subject of wide general interest.

3.7 The Development of Franchising is Uneven across China

However, although franchising has been enthusiastically embraced in China by enterprises looking to expand, as well as by individuals wishing to enter business sectors using another's proven system, the development of franchising is uneven across China. Franchising is well developed in the major cities such as Guangzhou, Beijing and Shanghai which has been most exposed to economic reform and Western influences, but the vast majority of Chinese do not live in these major cities. The benefits of economic reforms have not been evenly shared across China and, to the majority of the Chinese population, franchising is still not well known. The chain store (including franchise chain and direct owned chain) and retail enterprises in the municipalities of Shanghai and Beijing and the provinces of Jiangsu and Guangdong account for almost 70 percent of total chain store and retail sales of the whole country.

3.8 Many Domestic Franchising Systems are still at an Earlier Stage of Development

Another reality of the Chinese franchise sector today is that many domestic systems are still at an early stage of development. Successful franchise systems develop from successful prototype business operations and pilot operations, from which the essential operational formats and management systems are tested, refined, and documented. Franchising is the replication of a proven business concept through a proven business system. It has been the metamorphosis of franchising from unsophisticated product and trade name distribution arrangements to comprehensive business format franchising arrangements which has driven the growth and development of franchising throughout the world. The essence of contemporary business format franchising is the replication of proven systems incorporating comprehensive managerial and operational protocols. However, in China, domestic franchising is generally at an early developmental stage. 30 percent of franchisors do not have a franchise manual, and 20 percent have no operations manual. The term “franchise” is widely used to describe arrangements which often simply unsophisticated distribution arrangements are offering little in the way of operational formats, assistance and training.

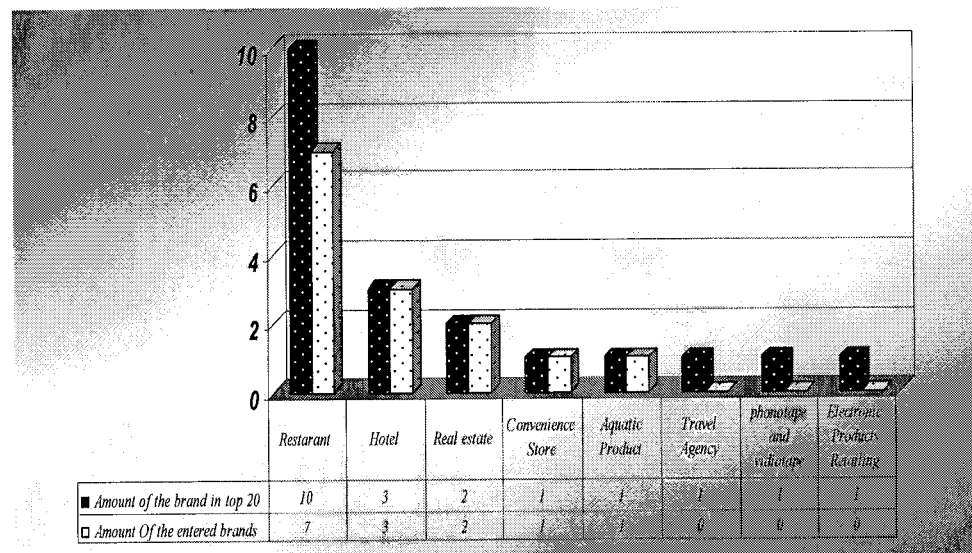
3.9 The Original Countries and Lines Involved

According to a list of the “Top 200 American Franchising Brands for 2005” compiled by American “Franchising Times “, more than 60 franchising brands have entered the Chinese market. Specifically, 14 of the top 20 franchising brands now operate in China which accounts for 65 percent.

The rest are from Singapore, Japan, South Korea, Hong Kong, Taiwan, and European countries including Germany, France, England and Italy.

Statistics of CCFA shows that of the lines involved in franchising, restaurant and retailing industries account for the largest proportion, while of the lines covered by the international franchising brands which have come into the mainland of China, restaurant brands dominate. Of the 14 franchising brands among the top 20 American franchising brands which have come into the mainland of China, 7 belong to the restaurant industry which accounts for 53.8 percent, 3 belong to hotel industry which accounts 23 percent of the 14 (See Figure 3.4).

Figure 3.4 The distribution of top 20 American franchising brands and the situation in the mainland of China



Source: CCFA Blue Book, 2005

It can be discerned from the chart that the franchising brands which have come into the Chinese market cover nearly all the industries except for

those which are unable to enter the domestic markets due to current Chinese governmental policy restrictions.

According to the terms of WTO, China will eventually fully open the retailing and service industries to foreign capital and given the upward trend of the economy at home as well as the gradual improvement of the business environment for business format franchising, franchising brands in other industries are developing quickly.

Current franchising opportunities that are starting to become established in China can be seen in the following Table 3.2.

Table 3.2 Franchising opportunities in China

| |
|------------------------|
| Fitness |
| Education and Training |
| Economy Hotel |
| Business Travel |
| Hairdressing |
| Express Delivery |
| Transportation |
| Home repair |
| Specialty shops |
| Child care |
| Sports staffing |
| Perfumeries |
| Cosmetic stores |
| Clothing stores |

Source: CCFA 2006 Blue Book Report

3.10 Benefits of Franchising in China

Sheppard (1999) points out that several factors influencing China's economy are favourable to franchise. Firstly, the infancy of China's franchise sector creates many opportunities for international franchising. Meanwhile, the Chinese government is actively encouraging foreign

investments flowing into the Chinese market. Because of the fast growing economy and increased wealth levels, there are many entrepreneurs available with access to capital for business investment. In addition, there is a superfluity of formerly state-owned and controlled small and medium sized enterprises that are ready to restructure their operations and affiliate with larger networks. Finally, the improvement in telecommunications, distribution networks, and business support services such as accounting, legal and advertising consultancies, has created China as an attractive market to foreign investors (Sheppard, 1999).

Conversely, China is keen to attract these investors who will bring many social and economic benefits. Apart from the boost to its economy from additional foreign investment, franchisors also will provide quality imported products and brands that are in demand by Chinese consumers. Meanwhile, these foreign franchising investments also provide entrepreneurial opportunities for local investors to learn advanced franchising experience from westerners and expand their domestic franchising business successfully (Zeidman, 1999). In other words, franchisees in China will benefit from the transfer of the successful franchisor's valuable experience, providing them with a proven business concept and established brand equity. An advantage of joining a franchise system is the initial and ongoing support provided by the franchisor (Terry, 1993a). Hence, franchisees can expect assistance with site selection, training, operational procedures and marketing practices.

Foreign franchisors will also benefit from the relationship. Firstly,

franchise enables franchisors with limited resources to more quickly saturate a market due to the payment of entry fees by franchisees. In addition to economic advantages, the franchisor will benefit from the franchisee's in-depth knowledge of the local market which would otherwise be a barrier to entry (Teegan, 2000). The unique nature and interdependence of the franchising relationship allows both parties to succeed (Carney and Gedajlovic, 1991; Terry, 1993b). Finally, because China is such a large potential market which would be difficult to serve under a single entity, franchise may be a more suitable organisational form (Sheppard, 1999).

3.11 Franchising as a Market Entry Strategy

Until recently it was routinely assumed that international franchising was merely a replication of domestic franchising practices (Teegan, 2000). However, in reality it is a much more complex process and franchisors should not expect to be able to transpose their systems to a foreign environment with only little modification. Several choices are available for entering overseas markets including direct franchising, master franchising, area development, joint venture arrangements and wholly foreign-owned subsidiaries (Chow, 1994; Petersen and Welch, 2000; Teegan, 2000).

Under direct franchising the franchisor negotiates with individual franchisees as is normally carried out under domestic franchising arrangements. Master franchising introduces another level of ownership and management by allowing a master franchisee to sub-franchise the

system to individual owner-operators. Again, a similar practice may be carried out in the domestic market. Area developers are granted the right to open a network of outlets operated by employee-managers in a specific region and are similar to multi-outlet franchisees in domestic franchising arrangements. Joint ventures involve the creation of a separate legal entity in which outlets are jointly owned by the franchisor and a Chinese partner who is familiar with the local business environment. Alternatively, a wholly foreign-owned enterprise may be established in the host country with the advantage of providing the franchisor with greater control over its intellectual property (Petersen and Welch, 2000).

Several factors influencing China's economy are favourable to franchising. Firstly, the infancy of China's franchising sector means that many opportunities are available for foreign operators. The Chinese government is actively encouraging foreign investment and a National Franchise Association has been formed. Due to the burgeoning economy and increased wealth levels there are many entrepreneurs available with access to capital for business investment. In addition, there is a superfluity of formerly state-owned and controlled small and medium sized enterprises that are ready to restructure their operations and affiliate with larger networks. Finally, the improvement in telecommunications, distribution networks, and business support services such as accounting, legal and advertising consultancies, means that China is an attractive market to foreign investors (Sheppard, 1999).

Conversely, China is keen to attract these investors because of the many social and economic benefits that will follow. Apart from the boost to its economy from additional foreign investment, franchising will provide quality imported products and brands that are in demand from consumers, entrepreneurial opportunities for local investors, and a track record of successful operations which may be copied by local businesses (Zeidman, 1999).

Franchisees in China will benefit from the transfer of the franchisor's valuable experience, providing them with a proven business concept and established brand equity. An advantage of joining a franchise system is the initial and ongoing support provided by the franchisor (Terry, 1993). Hence, franchisees can expect assistance with site selection, training, operational procedures and marketing practices. Foreign franchisors will also benefit from the relationship. Firstly, franchising enables franchisors with limited resources to more quickly saturate a market due to the payment of entry fees by franchisees. In addition to economic advantages, the franchisor will benefit from the franchisee's in-depth knowledge of the local market which would otherwise be a barrier to entry (Teegan, 2000). The unique nature and interdependence of the franchising relationship allows both parties to succeed (Carney and Gedajlovic, 1991; Terry, 1993). Finally, because China is such a large potential market which would be difficult to serve under a single entity, franchising may be a more suitable organisational form (Sheppard, 1999).

3.12 International Franchising Firm's Entry Strategies in China

It is found in the research that most of the brands use the multi-unit franchising method, mainly due to the lack of a sufficient mastery of the domestic cultural customs and the challenge of finding high level human resources with the requisite business and cultural backgrounds. There are two different franchising strategies, one is indirect franchising, and the other is company-ownership franchising method. According to the different approaches the international franchising brands are taking in the entrance to the domestic market they are more inclined to choose one kind of company-ownership franchising method.

Meanwhile, there is a rapid and stable development in the Chinese market for the foreign restaurant groups, which are represented by McDonalds' and YUM, through the method of indirect entry mode and later direct franchising. Now, their markets are spread out from big cities to small cities. However, some companies with international franchising brands which adopted this approach without a Chinese headquarters location ran into a lot of setbacks. These failures may enlighten the newcomer and give us pause to reflect on what kind of market entry strategy should a company adopt to achieve success in China. Competition is increasing globally with more and more markets opening up, often offering new competitors who may be able to increase their global market share if they can successfully create management models that allow them to gain a competitive advantage.

3.13 The Spread of Franchised Outlet

According to the China Chain Store and Franchise Association, the international franchising brands in China developed at 40 percent per year speed during the last five years. Different strategies have been adopted by international franchising brands according to the different industry, in part due to differences in regional economic development and in part due to cultural issues. Generally speaking though, Beijing, Shanghai, and Guangzhou are the primary centres best suited to the development of franchised outlets (Li, 2004).

3.14 The Challenges in the Chinese Market for International Franchisors

3.14.1 Lack of Healthy Commercial law Environment

As in other countries, the law has a significant role in improving the environment for franchising. UNIDROIT (2005) defines that a healthy commercial law environment is “one with general legislation on commercial contracts, with an adequate company law, where there are sufficient notions of joint ventures, where intellectual property rights are in place and enforced and where companies can rely on ownership of trademarks and know-how as well as on confidentiality agreements”.

Generally speaking, laws relevant to the franchise operation such as intellectual property protection law, joint venture law, foreign owned enterprise law and contract law have been revised according to the

requirements of WTO accession. However, the enforcement of the laws is an ongoing concern.

Franchise specific problems have to some extent been addressed by specific franchising regulation. China was one of the first countries outside the US to adopt specific franchising regulation. The 1997 Administrative Measures on Commercial Franchising (Trial Implementation) (the 1997 Franchise Measures) were promulgated by the then Ministry of Internal Trade “for the purpose of standardizing franchise operations, protecting the lawful rights and interests of both the franchisor and the franchisee, and further promoting the growth of chain business” (Franchise Measures, 1997, Article One). The 1997 Franchise Measures, together with other relevant regulations, provided a basic framework for the operation of franchising in China at that time, but applied only to domestic enterprises which created doubts as to the status of foreign franchisors and the enforceability of their contracts. To meet its WTO commitments, the Ministry of Commerce issued new Administrative Measures on Commercial Franchising (the 2005 Franchise Measures) on the last day in 2004, which took effect on February 1 of 2005. The 2005 Franchise Measures establish legal requirements for franchise operations in China for both foreign and domestic franchisors. It honoured WTO commitments by subjecting domestic and foreign franchising enterprises to the same regulation. (The 2005 Franchise Measures nevertheless provide that before a foreign invested company can franchise in China, it must first obtain approval from government agencies, which is not a requirement for a domestic company). The 2005 Franchise Measures prescribe the necessary

qualifications of franchisor and franchisee and their rights and obligations, (including a requirement for an enterprise to have at least two stores in operation for more than one year within China prior to commencing franchising). They also prescribe prior disclosure requirements, the content of the franchise agreement and sector administration. The 2005 Franchise Measures have generally been welcomed not only because the introduction of a viable regulatory regime for both domestic and foreign franchisors, but also because their recognition of “freedom of contract” and their emphasis on intellectual property protection.

It is nevertheless acknowledged by Guo (2004), the Chairperson of CCFA, and by Wang (2004), Director from the Ministry of Commerce, that a more professional and comprehensive specific franchise regulation at the State Council level (as opposed to the current Ministry rules) is an urgent priority for the orderly growth of the franchise sector. Although the State Economic and Trade Commission responsible for the proposed “Commercial Franchise Regulation” stated as early as July 2002 that the new regulation would be implemented before the end of that year, it has still not appeared.

The law clearly has an important role in China, as in other countries, to address the growing pains of a rapidly emerging franchise sector. However, it cannot solve all the problems.

3.14.2 Balancing Localization with Standardization

Balancing localization with standardization is a challenge for both domestic and foreign franchising systems as the observation is frequently

made that China is not “one country” from the consumer’s and the franchisor’s perspective. In relation to domestic franchisors, most local franchising systems are not yet strong enough to be a real threat to established international franchisors because they lack the key elements for a successful franchising system, such as a recognized brand, a proven system and know-how, which are the innate advantages of established foreign franchisors.

3.14.3 Unfamiliar with the Chinese Market

Foreign franchisors nevertheless face real challenges. They are unfamiliar with the Chinese commercial environment, consumption psychology and industry conditions. Finding the right partner and senior management is both time consuming and difficult. Cultural issues require particular sensitivity for foreign franchisors. China is rapidly moving to a more familiar Western business environment, but a 5000 year culture cannot be expected to change overnight. It is not only language – which in its spoken form has many dialects – but more entrenched characteristics. Prominent among these is the concept of “Guanxi”. In literal terms, the central concept of Guanxi in Chinese culture means 'relationships' or 'connections'. Guanxi is a network of elaborate relationships promoting trust and co-operation and for centuries was the main way of accomplishing everyday tasks. Establishing a sincere, supportive relationship based on mutual respect is a fundamental aspect of Chinese culture. In the world of business, possessing the right Guanxi is crucial for ensuring the minimization of difficulties and frustrations that are often encountered (Chen, 1995). The prime importance of personal connections, networks

and relationships with business partners, government officials, media and trade associations are forged through sustained cooperation, commitment and contact.

The Chinese adopt the philosophy that: “while nothing is easy, everything is possible”. Despite the challenges, companies which have adopted this attitude have achieved great success in China (Li, 2004). As noted above, KFC negotiated with government authorities for nearly three years and devoted another 20 months for developing its supply chains training staff and refining its system before the first outlet opened in Beijing. The turnover of its 1,200 outlets of 2004 in China reached RMB12 billion (approximately US\$ 1.5 billion) which is nearly one third of the total turnover of its 5,524 outlets in USA (US\$4.9 billion in 2003) Huang (2005). Yum! KFC and Pizza Hut in China claim that “KFC makes almost as much money in China today as it makes in the US” (Novak, 2004). In order to acquire the major Chinese film manufacturers, it takes Kodak four years to conduct seven round negotiations with the Chinese. In 1998 it invested US\$1.2 billion, its largest overseas investment, and it has established a near monopoly position in the film-manufacturing sector in China. It has also expanded its Kodak Express network through franchising with the support of the Bank of China, and now has more than 8 000 outlets in China (CCFA, 2005).

3.15 The Opportunities

With its rapid economic growth and “the world’s largest potential market, embracing 1.3 billion people including 412 million young consumers

under twenty, and with rapidly rising levels of disposable income in economically booming urban area” (China Statistic Bureau, 2004) China is an increasingly attractive franchise market international franchising firms.

3.15.1 Increasing Disposable Income

Increasing disposable income has made it possible for more Chinese consumers to source higher quality products and services. Chinese consumers are increasingly sophisticated and brand conscious. There is an increasing demand for standardized quality which franchise networks can provide an increasing preparedness to pay more for well-known brands. Post WTO market liberalisation reforms have facilitated foreign investment in the franchising sector and foreign franchisors are entering in increasing numbers. China’s WTO commitments to franchise operations include removing restrictions on geographical location, number, equity ratio and form of establishment for foreign investment. These obligations have largely been met through the 2004 Measures for the Administration of Foreign Investment in the Commercial Sector and 2005 Franchise Measures.

Law and regulations improvement in China will benefit those international franchising firms to adopt direct franchising entry mode in China.

3.15.2 Economic Reforms

Not surprisingly, the economic reforms which have made possible the development of franchising have not been without casualties. The reforms of past twenty years have resulted in some welcome and previously known

consequences, including a rising economic growth rate. So international franchising firms can adopt direct entry mode into China as the profit is relatively high. Thus it can reduce the running cost in the Chinese market. It also can reduce the management risks as the potential demand is high.

3.15.3 An Ample Supply of Potential Franchisees

The existence of unemployment and the prevalence of entrepreneurship provide an ample supply of potential franchisees. The development of Chinese private companies and the growth of private capital provide a solid base for franchising business. China has a great number of potential franchisees with strong sources of funding. International franchising firms can take these advantages to adopt direct franchising entry mode. .

3.16 Prospects of International Franchising Brands in China

After more than ten years' development, the franchising environment has greatly improved in China. Many international franchising brands, which have come to the fore in the global economic competition or have been developing to higher and higher positions, have to attribute those achievements to their successful development in China. KFC, for example, develops at such an amazing speed that its rank jumped from the 29th in 2003 to the 4th in 2004. Meanwhile, the number of KFC's franchised outlets in China market has also surmounted 1200. According to the data and material obtained from this investigation, we can predict that the international franchising brands will achieve a much greater development in China, which will mainly take on the following features:

- (1) More standard franchising environment;
- (2) Broader fields, modes and investors;
- (3) More frequent merger and acquisition.

The following sections explore these specific features related to future development in the Chinese market.

3.16.1 More Standard Franchising Environment

The standardization of a market is promoted not only by inner requirements but also by external impetus. In order to select favourable inland and overseas franchised items, investors must be more cautious. The competition of both domestic and overseas franchising firms will also become fiercer. These all impel each franchising firm to operate more standard and transparently. “Administrative Regulations on Business Format Franchising” promulgated by Ministry of Commerce in 2005 further approved the business format franchising pattern from the side of administrative law. Moreover, it attributes a lot to the standardization of franchising market.

3.16.2 Broader Fields, Modes and Investors

While China is in the process of fulfilling the overall WTO entrance promises, the China market has also become more open. There will surely be lots of international brands from various fields entering China through the franchising pattern. Meanwhile, due to its advantages of low-cost and high-expanding-speed, franchising will become an important pattern for numerous international brands to enter China. As for franchising modes, in

addition to unit franchising and multi-unit franchising, many more new franchising patterns combining different operating modes will appear.

The investigation data of investors obtained from the franchising exhibition, which was held by the Franchising Association of China, demonstrates that internal franchising investors will break the former phase in which state-owned or large companies are dominant, and develop gradually to be made up of economic organizations and individuals from various layers, including small and medium companies, privately owned enterprises and individual investors, even people studying abroad.

3.16.3 More Frequent Merger and Acquisition

Merger and acquisition has become one of the significant methods through which firms can expand scale and enter new markets quite fast, low down the entering threshold efficiently, and greatly strengthen their competitive power in local market. There are countless examples in merely retailing, store and hotel management industries. In the meantime, famous international franchising brands are all very cautious when they enter a new market. Before entering, they will spend a fairly large cost to do research work and get familiar with the market. But once they confirm there is sufficiently developing potential in that market, they will take every method to enter in, regardless of the cost. And those international franchising brands, which hold fairly abundant capital, fully have the capability of entering a new market through acquisition. Therefore, we can predict that merger and acquisition will be a significant method for

international franchising brands to enter China.

Over the last decade, the franchise market in China has been growing at extraordinary speed, originally under the influence of foreign franchise systems but more recently through domestic enterprises adopting a franchising strategy. Rapid growth has nevertheless been accompanied by predictable problems including enterprises, domestic and foreign, franchising unproven concepts and immature systems, and improper conduct which persist despite the regulatory attempts to prevent it. These problems should become less significant with increasing knowledge of franchising, continuing modernization of the legal system and more effective avenues for enforcement of contractual obligations and intellectual property rights.

3.17 Chapter Summary

This chapter reviewed franchising development in China. It briefly introduced the concept of franchising, explained the reason to franchise, and presented a descriptive study of the evolving contemporary franchising industry in China.

Chapter 4

Research Philosophy and Methodological Issues

4.1 Introduction

The purpose of this chapter is to discuss paradigmatic assumptions on which this research is based and to justify the epistemological and methodological approach selected. This discussion includes how the research was design, what sampling method was used, in which way, the questionnaire was developed and administrated to support the research topic. Further to this, techniques of data analysis used in this study were addressed. Finally, main limitations and ethical issues are considered at the end of this chapter.

4.2 Research Philosophy

Research philosophy reflects a researcher's assumptions of the way he/she reviews the world. There is a long historical relationship between philosophy and social science. How to organise and conduct social research has been debated for many years by philosophers of science and methodologists (Smith and Dainty, 1991). Their arguments involve ontology and epistemology that further lead to fundamentally different research paradigm: Positivism and phenomenism (Allan, 1998; Smith and Dainty, 1991; Strauss and Corbin, 1998; Collis and Hussey, 2003)).

Social ontology deals with the nature of existence (Hughes and Sharrock, 1997). Epistemology is concerned with how the world to be understood by

researchers, how they can ensure the knowledge they claimed is adequate and legitimate (Maynard, 1994). These philosophical stances guide researchers to justify their methodology which direct the research methods researchers adopted in their investigation.

Form an epistemological viewpoints, the debate has been termed as 'positivism verses phenomenalism'. Positivism is based on the assumptions that reality is external and objective. The implications of this research philosophy are independence, hypothetical-deductive (Smith and Dainty, 1991). According to positivism, researchers' values, interpretations and feelings have no place in analysing data. In other words, positivists aim to construct a set of theoretical statements to emphasize the generalization of the results of the research (Gall, Borg, and Gall, 1996).

On the opposite side, the phenomenological school insists that knowledge is acquired through the experiences of people. It is highly dependent upon the subjective interpretations of human being lives, feelings and experiences (Sanders, 1982, Strauss and Corbin, 1998). Phenomenology stance is associated with subjective ontology which is against that the world is just 'out there'. Phenomenologist believes that to understand the objective 'out there', meaning must be given subjectively in the sense of knowing the phenomenon in the world (Crotty, 1998).

Due to the nature of the philosophical assumptions, different research purposes lead to different research philosophical choices. According to the

aims and objectives of this research, the author claims that positivism is to be applied for this study which focuses on finding out the relationship between the factors and franchising entry mode choices. This relationship is external existing. The findings of this research should be generally applicable and support the universal knowledge.

4.3 Research Methodology and Method

Sekaran (2000, p.175) defines research as “a somewhat intimidating term for some, is simply the process of finding solutions to a problem after a thorough study and analysis of the situational factors”. Applying this definition to business research context, Business Research can be described as ‘the systematic and objective process of gathering, recording, and analyzing data for aid in making business decisions’ (Zikmund, 2000). Needless to say, no matter what research it is, data collection is an essential step during the whole research process.

Different research philosophical stances lead to different methodological choices. the most commonly used methodological approach can be classified into: qualitative and quantitative methodology (Zikmund, 2000; Sanders, 1982, Strauss and Corbin, 1998; Smith, Thorpe, and Lowe (2001). Qualitative research is used for problems requiring an understanding. It deals with explanatory concepts (Robson and Foster, 1989). Qualitative methodology, generally associated with phenomenological epistemology, refers to forms of data collection and analysis which rely on understanding, with an emphasis on meanings. Against qualitative methodology, Marshall

(1998) points out that quantitative methodology, generally associated with positivist epistemology, is usually regarded as referring to the collection and analysis of numerical data.

Accordingly and naturally, the methods employed by qualitative and quantitative researchers vary in types and structures. From business perspective, the most common methods relevant to quantitative and qualitative research are surveys and case studies (Sekaran, 2000).

Methodologically, international franchising research has been largely positivistic and quantitative in nature in the past (Alexander, 1990; Myers, 1995; McIntyre and Huszagh, 1995). Much work such as that by Vida (2000) still continues in the quantitative, positivistic tradition. The methodology employed here adds to this quantitative work. Underlying the positivism philosophical stance, this research employs a survey consistent with quantitative research methodology. There are considerable advantages to employing quantitative methodology. The methods of data collection employed by a quantitative researcher, compared with a qualitative research, are more diverse, simpler, and more straightforward as quantitative methods focus on numerical data collection and analysis. By using the survey data collection method, it would enable testing existing theories to achieve the advantages of generalizability and repeatability.

As the purpose of this study is to examine the factors influencing the international franchisors to choose franchising as an international entry

mode into the Chinese market, deductive data generation and analysis through survey method is deemed appropriate.

4.4. The Survey Research

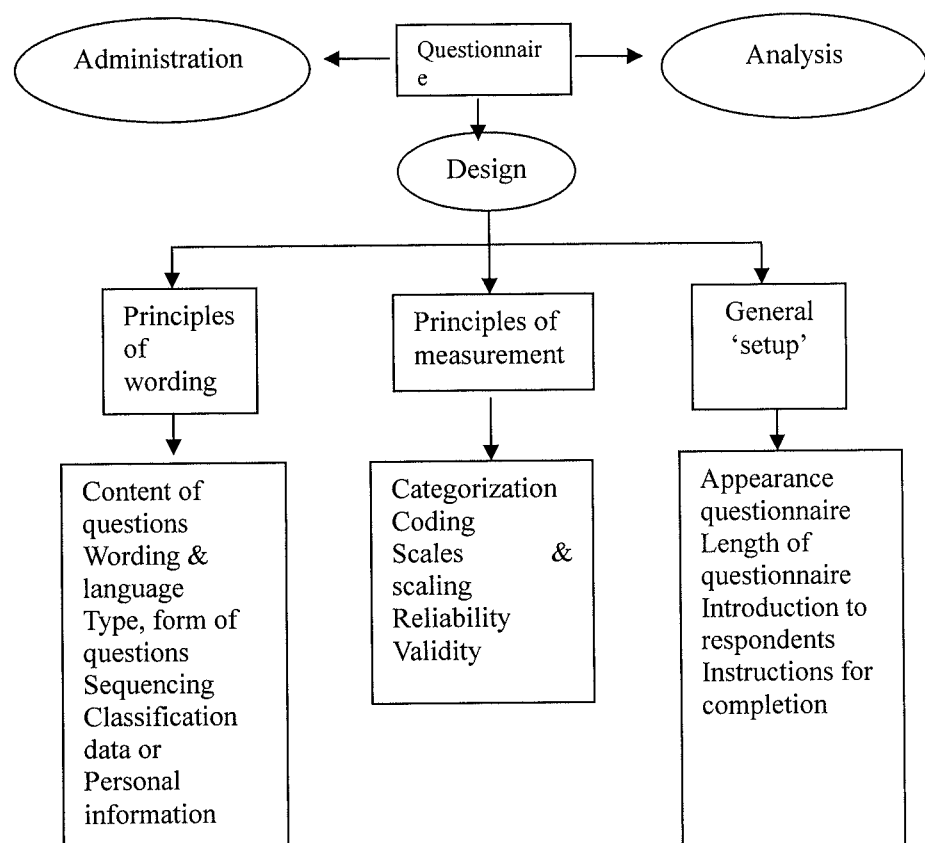
Given the lack of research on this topic hitherto, and the ability of quantitative research to find out the relationship between factors and entry mode choices, a survey design was employed and the study framed within positivist research paradigm.

Having mentioned earlier, a survey has been employed as the research method underlying quantitative methodology for this study, consequently, a questionnaire should be designed before data collection conducted. The survey is an effective tool to get opinions, attitudes and descriptions as well as for getting cause-and-effect relationships (Ghauri and Gronhaug, 2002). In addition, surveys are particularly useful in describing the characteristics of a large population and, especially, self-administered surveys make large samples feasible (Babbie, 2001). A survey is also an appropriate method when there are time and resources constraints. In terms of the time dimension, a cross-sectional method, which is designed to obtain information on variables from any given sample in different contexts only once (Malhotra and Birks, 1999), was used in this study as there were constraints of time and resources. Broadly speaking, if a questionnaire is expected to achieve the researcher's purpose, care must be taken in the design of the questionnaire.

4.4.1 Initial Questionnaire Design

Although each stage of the business research process is important because of its independent nature, questionnaire design, however, is one of the most critical stages in the survey research process (Zikmund, 2000). With regards to the questionnaire design, relevance and accuracy are the two basic criteria to be met for a good questionnaire. In light of these principles, questionnaire design should focus on a several aspects, including wording, constructing and presenting shown in the following figure.

Figure 4. 1 Principles of questionnaire design



Source: Adapted from Sekaran (2000, p175)

As Table 4.1 indicates, questionnaire design is not an easy task; it requires many skills in different levels. Extra attentions must be paid to the wording and language, the type and form of the questions, the sequencing of the questions etc., during the questionnaire design.

Initially, particular attention was paid to the wording, form and sequences of the questions. The researcher tried to choose simple words to ensure all questions were understandable. Among 20 questions, 18 of them were designed as closed questions so that the respondents can make quick answers. In order to let the respondents make additional comments on this topic, two open-ended question was placed at the end of the questionnaire. In addition, the order of the questions was another factor in this questionnaire because sequence is very important to the success of a survey. Considering this point, the main principle employed is to make the beginning questions simple, interesting, and easy to answer, then ask more challenging questions in the middle. By doing this, the respondent's cooperation and confidence can usually be maintained throughout the questionnaire.

4.4.2 The Pilot Study

A pilot study is a small-scale rehearsal for a larger main study and follows naturally from a written protocol. The purpose of a pilot study is to learn more about the data acquisition process without investing large amounts of time and resources. A pilot study was conducted before the questionnaire was finalised. As Teijlingen and Hundley (2001) suggest, conducting a pilot

study does not guarantee success in the main study, but it does increase the likelihood of success as pilot study refers to any small-scale exploratory research technique that uses sampling but does not apply rigorous standards (Zikmund, 2000).

The first objective of the pilot study was to clarify the survey instruments. Secondly, the pilot study assessed the reliability of the designed questionnaire. Then the author can find the defaults of the questionnaire and get much advice from the respondents that can make the questionnaire more acceptable and valuable. It is necessary to test and revise the questionnaire before it is conducted in large scale. So after the initial questionnaire design, a pilot study in a small scale before it was conducted in a large scale.

The pilot study was carried out in August 2005. It was conducted involving 20 international franchisors who had knowledge of franchising strategic choices from the different industry sectors: fast food, retail etc. Ten copies were sent by e-mail while the others were sent by post. Two weeks later, 15 copies of the completed survey were returned, giving a return rate of 75 percent. Through the pilot study, the questionnaire proved to be effective. Yet more specific questions were added to the questionnaire to be used as an instrument for the main study.

4.4.3 Revised Questionnaire

Based on the pilot study, the research questionnaires were revised in an

attempt to ensure that the survey research matched the aims and objectives of the research. The author used the pilot study to adjust the questionnaire questions in order to make sure that the questions covered the factors the respondents identified.

The results of the pilot study showed that all of the asked questions were clear and understandable – even though some of the respondents gave some advice on the wording of particular questions.

For example, the pilot study questionnaire consisted of 25 questions, of which were 3 open questions. The respondents mentioned that some of the close-ended questions were beyond their ability to answer and that there were too many open-ended questions. According to their suggestion, the author deleted one open-ended question and four close-ended questions.

After the small pilot study, the initial questionnaire was revised and the final version was conducted (see Appendix B). It consists of four parts and 20 questions, two of which were open-ended and the rest were close-ended. A two-sided questionnaire with all 20 questions was then printed on an A4 white paper. To help with the analysis, most questions were coded numerically.

Part A is about International franchising firm's company profile in China (Q1-10). Part B consists of factors affecting international franchising firm's operation in China (Q11-17). Part C used a 5-point likert type scale ranging

from very important to unimportant to gather in out from the respondents as the factors influencing the firms market entry and penetration strategy in China. Seven factors as identified in the table were developed on the basis of the pilot study as well as relevant literature discussed in Chapter 2. Respondents were requested to choose the importance from 1 (very important) to 5 (unimportant). The purpose of this question was to reveal the influence of these factors on international franchising in China. This will be discussed later in this chapter. Part D consists of two open-ended questions. The purpose of this part is to give additional insights as to the other complementary factors influencing international franchising firms' entry mode choice in China. This will be discussed in the following chapter.

Once the sample list was selected, specific sample participants were generally identified from franchisors listings in the publicly available directories of franchisors (For example, the Sourcebook of Franchise Opportunities in China); from CCFA (China Chain and Franchising Association) statistics books and IFA (International Franchising Association based in USA) statistics books.

As stated earlier, questionnaire design is the essential step during the survey, but if the research populations or samples are not correctly targeted, the survey will be unsuccessful insofar as certain data cannot be collected from persons who cannot provide the correct information to solve the problem, even if the designed questionnaire is perfect. That is, sampling the right

people to answer the questions is as much important as questionnaire design. In an effort to gather input from the right sample, the researcher turned to the CCFA. It is estimated that there are about 500000 foreign firms in China, of which 500 involve with international franchising (CCFA, 2006). From this list, a total of 400 potential respondents were selected mainly from first-tier cities as well as large cities in an effort to get their feedback for this research.

4.4.4 Administration of Questionnaires

Not only is it important to take great consideration of the questionnaire design, it is also important to pay attention to how the questionnaire is administered. There are several ways of administering questionnaires. They can be self-administered by a researcher or an assistant hands them directly to the respondents. Alternatively, they can be mailed by post or through e-mail via the internet. These questionnaires can also be set up as a web based survey using either email or post to direct the potential respondents. As Table 4.1 indicates that each method administering questionnaires has its own advantages and disadvantages.

Table 4.1 Features of self-administered and postal survey

| Methods | Advantages | Disadvantages |
|-------------------|---|--|
| Self-administered | -Less time-consuming -Easy collection -High return rate | -Organisations unwilling to allow distribution during work hours -Limited geographical coverage |
| Postal survey | -Wider geographical coverage -Convenience completion | -Low return rate -Cannot clarify doubts |

Source: Saunders, M., Lewis, P. and Rhornhill, A. (2006) Research methods for business students (3rd Edition), Prentice Hall.

As Table 4.1 shows, comparing postal questionnaire administration method, personal administrated questionnaire has its unique advantages, especially

in ensuring the respond rates. Moreover, it is less time consuming and with easy collection. A postal survey was conducted by the author for this study.

4.4.4.1 Questionnaire Delivering

As is often the case when dealing with specialized populations, a list was compiled by examining the most important three franchising industries including restaurant industry, retail industry and service. All sizes and types of franchise systems in each industry were chosen for the study if operations in China were indicated. In total, a postal survey was sent to a sample frame of 400 firms which were identified to have international franchise operations in the main cities in China. 400 questionnaires were personally distributed by post during a time span of about four weeks in Oct 2005.

4.4.4.2 Method Used to Secure the Return Rate

Another issue regarding administration of questionnaires is how to ensure the high response rate. As mentioned earlier, in order to boost questionnaire response rates, many aspects should be considered. For example, the author sent a cover letter to the respondents. This is a necessary and helpful method. The author also took other factors into consideration, such as research affiliation, researchers' credentials, the type of envelope and stamp used. This survey was completed by those senior managers who are involved with their company's strategic decision makings. After 3-4 weeks, for those who had not responded, either phone calls or e-mails were made.

4.4.4.3 Questionnaire Collection

Initially 19 were undeliverable, meaning 381 surveys were actually delivered (or at least did not get sent back as undeliverable). A total of 145 usable questionnaires were returned. Of these, 15 were excluded from the study due to the reasons of:

- 1) Firms that returned the form unanswered citing company policy against participation in surveys;
- 2) Firms that returned questionnaires with incomplete responses;
- 3) Firms that were not involved in franchise operations anymore. As a result, this brings the number of collected questionnaires to 130.

To prepare these questionnaires for analysis by using proportion difference analysis, the quantifiable data were typed, formatted to be input to the analysis computer software. Consequently, the final number of analysed questionnaires was 130 that achieved the effective response rate of 32.5 percent. No obvious differences emerged across meaningful variables such as years of international experience, number of units, and start up date of the organization.

4.4.5 Analysis of the Questionnaire

4.4.5.1 Data Editing and Coding

Even if the researcher has done a good job in questionnaire design and administering phases, the survey still can be a failure if the collected data cannot be properly analysed. After the data have been collected, the process of analysis starts with data editing, the process of making data ready for

coding and transferring to storage, and then data coding, the process of identifying and classifying each answer with a numerical score or other character symbol. Careful editing and coding make the later analysis easier.

4.4.5.2 Data analysis process

For the total of 130 valid questionnaires, the data analysis process of this study was managed in three steps:

(1) Editing and coding the data

After the data were collected in this research, the analysis started with data editing, the process of making data ready for coding and transferring to storage. Afterwards, the process of data coding were conducted to define the variables representing firm different characteristics and entry strategies, and to classify each answer with a numerical score. In this stage, careful editing and coding made the later analysis easier for this research.

(2) Summarizing the statistics of the characteristics of sample firms.

Based on the survey questions, the frequency and percentage of sample firms with different entry strategies are summarized. The frequency and percentage of sample firms with different characteristics are identified and presented.

(3) Hypothesis test – proportion difference test.

In order to test the hypothesis on the linkage between entry strategy and firm characteristics, the author adopts the following proportion difference test: first the author defines an entry strategy variable which is equal to 1 if

the firm chooses direct franchising and zero otherwise. Second, the sample firms are divided into different groups according to the different characteristics of firms (based on the survey questions). Third, mean comparison tests are used to compare the proportion of firms choosing direct franchising (μ) across different groups. For example, assuming there are two groups of firms x and y, which are different in certain characteristics. The proportion of firms choosing direct franchising for group x is μ_x and the one for group y is μ_y . The null hypothesis is, $\mu_x = \mu_y$, that there is no significant difference in entry strategy between these two groups x and y. The test of $\mu_x = \mu_y$ is given by

$$t = \frac{\bar{x} - \bar{y}}{(s_x^2/n_x + s_y^2/n_y)^{1/2}}, \text{ where } \bar{x}, \bar{y} \text{ are sample mean of entry strategy}$$

variable for group x and y; s_x^2, s_y^2 are standard deviation for group x and y; n_x, n_y are the numbers of firms in group x and y. This statistic is distributed as Student's t. If the t statistics reject the null hypothesis at the 5 percent significance level, the author concludes that the groups x and y have different entry strategy. This test is unconditional test, which investigate the linkage between certain firm characteristics and entry strategy without controlling for other firm characteristics.

4.5 Supplementary Research – A case study approach

In section 4.4, details of survey research are discussed. This section explains the purposes and process of using case study for this thesis. It consists of why case study was used when carrying out this research; how

case studies were conducted; what limitations of the case studies are.

4.5.1 Rational use of Case Study

Yin (2003) suggests that case studies are appropriate where the objective is to study contemporary phenomenon within some real-life context, and where it is not necessary to control behavioural events or variables. The greatest advantage of using case study is the necessity of providing a comprehensive understanding of the issues under investigation. According to Voss, Tsikriktsis and Frohlich (2002), the case study offers a high validity for practitioners and leads to new and creative insights into knowledge and practice. Via the case study, researchers can discover contextual conditions of the events through the systematic piecing together of detailed evidence (Hartley, 2004; Willig, 2001).

Case studies can be used in different types of research such as ‘positivist stance’ (Yin, 2003; Benbasat, Goldstein and Mead, 1987) or ‘interpretivist stance’ (Walsham, 1993; Myers, 1997), in other words, it can be ‘combined with a variety of different epistemological positions from positivist to phenomenological (Ghauri, 2004, p109)’. Case studies can be both quantitative and qualitative (Yin, 2003, Ghauri, 2004). The case study approach has been used in many types of research purposes, for instance exploration, theory building or testing, and theory extension or refinement (Voss et al., 2002). In this research, the main purpose of choosing the case study method is to check the author’s understanding and test the findings of the survey conducted earlier. Since this research is conducted in the

national context (the Chinese market), the case study is an effective way to understand the macro-environment, industry-level relationships and firm decision-making (Ghauri and Holstius, 1996).

4.5.2 Case Study Design

Case study research includes both single-and multiple-case studies. Yin (2003) suggests that multiple case designs are desirable when the intent of the research is descriptive, theory building or theory testing. Benbasat , Goldstein and Mead, (1987) note that multiple case studies are suitable for investigating “certain types of problems”. Multiple case studies enable the researcher to relate differences in context to constants in process and outcome, at the same time, to allow cross case analysis and extension of theory. Miles and Huberman (1994) argue that multiple cases enable the research to avoid those findings that are merely the result of idiosyncrasies of the research design. Comparing with single-case study multiple-case have distinct advantages, it is more compelling and regarded as being more robust (Herriott and Firestone, 1983). For the nature setting of this research and considering the time, by adopting multiple-case studies approach, the author decides to conduct two case studies within fast food industry. The selecting of cases is described in the next section.

4.5.3 Selecting Case Studies

How to select the cases is the most important issue in conducting the case study. The selection of the cases must be based on criteria that are consistent with the nature of the research problems and objectives (Yin,

1994; Ghauri, 2004). This research is studying the decision making in terms of international franchisors' entry strategies in Chinese markets. The selection of the firms must be operating in franchising format in China and the informants have to be managers who are the key decision markers. Since fast food industry is the most developed franchising industry in China and it was the first industry that was involved by the international franchisors in Chinese markets. Therefore, the two selected cases are all from fast food industry. They are highly reputed American franchising firms KFC and McDonald's in China. According to Ghauri (1992) and Ghauri and Fang (2001), choosing MNCs can gain richer information but likely can be difficult to access to these organizations. In this research, as the author has used various resources to approach the informants.

4.5.4 Participant Enterprises

Once the organizations have been selected for the case studies, another important issue is to approach and choose the right informants. As an important strategy, the author decides to negotiate with people who are the key persons and have wide and deep relationships with organisations. Owing to cultural difference in the East, Guanxi and personal networks played an important role in conducting this research. During DBA studies, the author has gained great help from her friends and old colleagues in contacting the key person, manager or owner from these organizations. The author's personal contact built from previous years' studies also helped her in approaching the participants who are willing to be interviewed. After many times of telephone communications and negotiations, managers from

these two organisations firmly agreed to contribute their time and experience to this research. The managers the author interviewed are those persons who are in charge of strategic management in their companies and used to involve in their entry decision making.

4.5.5 Collecting Data through Interviews

Yin (1994) argues that it is one of the important steps to decide how to prepare for data collection. Given the variety of sources of data potentially available to the researcher in the case study approach, such as observation, documents, attendance to meetings and interviews (Hartley, 2004), this research adopted documents and semi-structured interviews to develop evidences systematically.

One of the main purposes to examine documents of researched organization is to gain an overview which enables the researcher to learn something of the history and present strategic issues of the organization. Having gained an overview of the firms, the researcher tries to use semi-structured interviews getting more in-depth evidences. Data collected from interviews makes explicit the theories being tested. Among the variety of data collection methods, the interview is extensively used, it seems people live in an 'interview society' (Silverman, 1993). Through interview, researchers can best approach case participants' views and interpretations of actions and events (Walsham, 1995).. Another advantage of adopting interview method is that interviews are flexible enough to adapt different contexts of organisations and to pursue varied tracks and

suggestions, in order to seek theoretical sensitivity development through research process (Glaser and Strauss, 1967). Moreover, the great benefit of semi-structured interviews is that the interviewer can prepare a list of themes and questions in advance to have a clear direction and get the interview to be in control.

The informants of interviews in this research are managers who are responsible for market entry strategy in Chinese market. Each interview starts with a brief introduction of the purpose of the research in order to arouse the attention and interest of the interviewee. The interview guides provide a direction in allowing participants to review and respond to the results and questions derived from the survey. Meanwhile, the participants are encouraged to recall their decision-making and explore their opinions when initially entering the Chinese markets

Each interview lasted approximately sixty minutes, agreed by the informants, the interviews were tape recorded. Subsequently, the transcript of interview data was carried out immediately so that interviews and notes could be completed, whilst the experience was fresh in the mind. For these participants, research confidentiality is verbalized and confirmed with every informant to ensure anonymity and to protect personal privacy in the study.

4.5.6 Analysing the Case Studies

‘None of the analytic techniques should be considered easy to use (Yin,

1994, p.116)'. In case study analysis, one of the most important analytical techniques is a pattern-matching. For the explanatory research, Yin (1994) continuously argues that by pattern matching, it is important to discover if the patterns are related to the dependent or the independent variables of the study. As first step, the author conducted a case description and explanation (Ghauri, 2004). Afterwards, the categories were developed around the research topic and key themes. The interviewed data were examined to discover how they fit or fail to fit the categories developed previously. During the process, tables are used to search patterns and grouping similar 'facts' (Hartley, 2004). The specific quoted interview data were also used in analyzing the case data.

4.6 Validity and Reliability of the Research

Attempting to establish the validity and reliability is one of an important issue for researchers. Validity emphasizes how researchers can ensure results of the research were believable and credible. According to Lincoln and Guba (1985), credibility of a study can be used to establish internal validity. Transferability, alternatively, is used to assess external validity. Transferability is the degree to which results can be transferred to other context. In terms of reliability, quantitative researchers often demand repeatability to establish reliability of data, in this research, the author attempted hardly in ensuring the validity and reliability of this study from different aspects.

Ferbert (1974) argued that a questionnaire is reliable when it provides

consistent measures in all comparable situations and over time. Babbie (2001) suggests that one way of improving the reliability is to use established measures that have already proven their reliability in previous research (Barnes, Kitchen, Spickett and Yu, 2004; Park and Lessig, 1977; Vigneron and Johnson, 1999). In order to ensure the reliability of the measurements used in the questionnaire of this study, several previous measurements were adopted (Barnes et al, 2004; Park and Lessig, 1977; Vigneron and Johnson, 1999).

Remenyi, Williams, Money and Swartz,l (1998) suggested that a survey is valid when it is capable of measuring what it was supposed to measure. In short, if research methods used in each step are reliable, that will guarantee the conclusion being valid. An inevitable consideration in this study concerned the equivalence of the concepts, words or statements which are employed in different versions of the questionnaire (Berry 1980).

To ensure reliability in the field, the questionnaire for this survey was originally drafted in English and then translated into Chinese by the researcher who is a bilingual Chinese. The questionnaire was then back translated into English by a professor who is Chinese but speaks English as a first language.

In addition, a pilot study was conducted before the full-scale study. During this process, some modifications of the wording were made in order to ensure that the questions expressed the meaning they were supposed to. To

strive for reliability in research analysis, the researcher again employed triangulation techniques to assess the consistency of pilot study responses along with documentary information supporting and checking.

4.7 Research Method Limitations

Without doubt, no matter how much carefulness has been paid to the design and process of the research, every study remains its limitations. The limitation of this study mainly is the sample sources. In geographical terms, the samples were selected mainly from the first and second tier cities in China. Although most of the international franchising firms locate in Beijing, which is the capital of China where one-third of the population are from other areas, the results of this research may not represent of the whole population in China. Moreover, a major challenge facing international franchisors in China is to understand the differences between rural and urban consumers. China is divided by marketing executives into five "tiers" (Madden, 2005). The distinctions are not geographic; they are based on the population size of Chinese cities, as well as the sophistication and income level of their inhabitants. Tier one includes Beijing, Shanghai and Guangzhou, followed by large cities, small cities, towns and finally, in the fifth tier, rural villages. Even only focused on prosperous cities, additional studies should be carried out in Shanghai and Guangzhou, which are in southern China and, therefore, residents share different subculture from those in Beijing, which is in northern China.

However, as a whole research, the author is confident of its quality and credibility.

4.7.2 Ethical Issues

In terms of the research ethics, a few issues have to be concerned from different aspects, such as privacy of participants, informed consent, seek access to organisations and to individuals, collect, analyse and report the data (Bryman and Bell, 2004; Saunders, Lewis and Rhomhill, 2003; Zikmund, 2000). The conduct of the research may be guided by a code of ethics. In this research, the author followed a code of ethics by the University Ethics Committee of Northumbria University. The ethical issues emerged in the different stages in this research. With particular considerations of the 'power relationships' and 'privacy issues', research ethics for this study were spread into 3 stages: gain access; data collection; and data report.

Privacy is a major ethical issue in social research (Bryman and Bell, 2004; Robson, 1999; Saunders, Lewis and Rhomhill, 2003; Sekaran, 2000). Regarding privacy issue, consent letter can be sent to participants. The details of informed consent vary depends on the nature of the research (Saunders, Lewis and Rhomhill, 2003).

In this research, in the beginning of the questionnaire, a short statement was prepared to emphasize the privacy protection of participants, rights and use of the collected questionnaire data. Practically, great care was given in maintaining each participant right to anonymity in particular (Smith et al, 2001; Saunders, Lewis and Rhornhill, 2003).

In terms of the ‘power relations’, the author paid a great attention not to use her power to enforce and influence the participants to involve the survey and interview by using her powerful authority as a member of China Chain and Franchising Association (CCFA).

4.8 Chapter Summary

From research philosophy to research methodology and methods, this chapter has explained and discussed the process of the data collection and analysis underpin this research. Moreover, the details of the design and administration of the survey was explored. To ensure the quality of this study, validity and reliability of this study, and few issues were address followed by the limitation of this research. Finally, some ethical issues in the context of this study were also discussed.

The author will analyze the data of the survey by proportion analysis in Chapter Five and report the research results of case study in Chapter Six.

Chapter 5

Research Findings and Analysis

5.1 Introduction

Following the discussion of the research philosophy and methodological issues in the previous chapter, this chapter initially presents the analysis of the questionnaires. Secondly, this chapter summarizes and discusses the statistics of firm characteristics. Thirdly, this chapter discusses the hypotheses tests. Finally this chapter concludes with a chapter summary.

5.2 Questionnaire Analysis

Data analysis begins after the data have been collected. With a total of 130 completed questionnaires received back, the data analysis process of this survey is managed in four steps: (1) editing the data; (2) coding the data (3) summary statistics of firm characteristics, (4) hypotheses test: proportion difference test.

5.2.1 Editing the Data

Editing is the process of checking and adjusting the data for omissions, legibility, and consistency. By checking the raw data collected in this survey, positively, the researcher found that most questions were completed properly. All closed questions (Q1-Q18) were answered without omission.

Relating to responses to open-ended questions of questionnaire, data

editing is especially necessary. Examining all the completed questionnaires, among total 130 papers, 6 respondents skipped (or left blank) the final open-ended question.

After editing, data collected in this survey are more complete, consistent, and readable, and undoubtedly, it makes the data coding easier.

5.2.2 Coding the Data

The purpose of coding data is to identify and classify each answer with a numerical score or other character symbol. In this questionnaire, data coding for some data related to the closed ended questions has been done in the questionnaire design stage. As for the open-ended question (Q19, Q20), coding various categories of answers is more difficult than coding fixed-alternative questions as many different answers need to be interpreted. On the basis of the respondent's exact comments, data here can be coded according to classified categories in data editing process.

5.3 Summary Statistics of Firm Characteristics

This section describes the summary statistics of firm characteristics according to each survey question.

5.3.1 Entry Date

The respondents of this study are the international franchising enterprises that entered China between 1985 and 2005. The author divides the entry date into three periods: 1985-1989, 1990-1999, and 2000-2005. The survey question is as follows:

Q1. When did your firm enter China?

1985-1989 ☐ 1

1990-1999 ☐ 2

2000-2005 ☐ 3

Table 5.1 Frequency of entry date

| Entry Period | Frequency | Percentage |
|--------------|-----------|------------|
| 1985-1989 | 5 | 0.04 |
| 1990-1999 | 90 | 0.69 |
| 2000-2005 | 35 | 0.27 |
| Total | 130 | 1.00 |

The frequencies of entry period are reported in Table 5.1. Only 4 percent of firms entered Chinese market during the 1980's, while most of them (69 percent) entered China during the 1990s. 27 percent of firms entered China after 2000.

The data indicates that in 1980's only a few international franchisors entered the Chinese market. It indicates that franchising in China is a novel thing; it is just at an introduction stage. From the data, majority of the international franchising firms entered the Chinese market in 1990's. The reason is that the Chinese government encouraged foreign direct investment (FDI) in China. There are some favourable policies towards FDI. It also shows that the political stability of China is stable. But the number of the firms entering the Chinese market has declined from 69 percent to 27 percent during the 2000's. This may show that the local franchisors are becoming more competitive and mature. They are now fast developing in their domestic market. The competition of franchising in

China is becoming very sharp. The international franchisors who want to enter this market must take this into consideration.

5.3.2 Market Entry Strategy

Q2. Please indicate the type of your firm's initial market entry choice in China.

Direct franchising ☐ 1

Others ☐ 2

Table 5.2 Market entry strategy

| | Frequency | Percentage |
|--------------------|-----------|------------|
| Others | 82 | 63.1 |
| Direct franchising | 48 | 36.9 |
| Total | 130 | 100.0 |

The frequencies of entry strategy are reported in Table 5.2. Most international franchising enterprises (63.1 percent) selected other entry mode choice as their initial franchising entry mode in China, 36.9 percent selected direct franchising. This data indicated that it is necessary for the author to find out: what factors influence the international franchising firms' entry mode of choice? Why majority (63.1 percent) international franchising firms chose other entry mode choices? This data set a good foundation for the author to further research.

5.3.3 Industry

Q3. Check the industry your company belong to in China.

Restaurant industry ☐ 1

Other service industries ☐ 2

Table 5.3 Frequency and percentage of industry group

| | Frequency | Percentage |
|--------------------------|-----------|------------|
| Restaurant | 38 | 29.2 |
| Other service industries | 92 | 70.8 |
| Total | 130 | 100.0 |

The frequency and percentage of respondents' industry are reported in Table 5.3. The sample firms are divided into two groups: restaurant industry and other service industries. 29.2 percent of the respondents operate in restaurant industry, and 70.8 percent operate in other service industries. The data shows that restaurant industry covers nearly one third of the international franchising firms operating in China. This matches the situation in China. Catering is the largest contributor to the Chinese economy. It gives the international franchising companies some reference. Restaurant industry still has large potential demand for future comers.

5.3.4 Home Country of International Franchisors

Q4. Your parent company is located in:

North America ☐1

Asian ☐2

Europe ☐3

The sample firms are divided into three groups according to their home countries: North America, Asian countries and Europe. The frequencies and percentages are reported in Table 5.4.

Table 5.4 Frequency and percentage of home country group

| Regions | Frequency | Percentage |
|---------------|-----------|------------|
| North America | 40 | 30.8 |
| Asian | 80 | 61.5 |
| Europe | 10 | 7.7 |
| Total | 130 | 100.0 |

The data shows that 61.5 percent of the franchising firms come from Asian countries, 30.8 percent come from North America and 7.7 percent from Europe. The data indicates that majority of the international franchising firms are from Asian countries and regions. This result tells us that companies from Asian countries were initially motivated to franchise in China as a result of closely culture and geographic distance. The current international franchising players in China are mostly from Asia. So if international franchising firms in North America and Europe can try to meet the culture gap and take proper entry modes, they could have much marketing opportunities in China as its potential market is larger and competition within firms from the same country will be ease. International franchising firms in Asian countries may face very severe competition if they want to do franchising in China as majority of international

franchising firms are from Asia. This result is consistent with the findings of Fladmoe-Lindquist (1996). It has the implication that the less the culture and geographic distance between China and bordering Asian countries, the more likely they enter the Chinese market.

5.3.5 Reputation and Brand recognition

Q5. Your reputation and brand recognition in China is

Very high ☐1

High ☐2

Normal ☐3

Scarcely knew ☐4

Table 5.5 Frequency and percentage of reputation and brand recognition

| | Frequency | Percentage |
|-----------|-----------|------------|
| Very high | 50 | 38.4 |
| High | 50 | 38.4 |
| Normal | 30 | 23.2 |
| Total | 130 | 100.0 |

Participants were requested to self report the relative positioning of their brands in with 1 indicating that their brand recognition is very high and 3 indicating that their brand is considered 'Normal' meaning it neither has very high nor very low recognition. 76.8 percent of the respondents believe that their brands are very highly or highly recognized by the Chinese, 23.2 percent of the respondents believe that their reputation and brand are normal.

The research data shows that high brand recognition and reputation is another motivation of international franchising firms to franchise in the Chinese market. Nearly 80 percent of the respondents believe that brand reputation is very important if firms want to franchise in China. The Chinese consumers have very strong brand recognition consumer behaviour. These international franchising firms who have the intension to enter into this market should have a high brand reputation and recognition. The research result consists with the findings of fortuitous franchisee interests/contact from third parties by Walker and Etzel (1973), Hackett (1976), Walker and Cross (1989), Welch (1989, 1990) and Abell (1991), Hackett (1976). This result implies that brand is a very important factor for international franchising business expansion in China.

5.3.6 Development Stage of International Franchising System

Q6. What was the Development stage of your franchising system at the time of your entry into China?

Penetration (Operation years 0-5, outlet number 0-10) ☐ 1

Growth (Operation years 6-8, outlet number (11-39) ☐ 2

Gradually getting mature (Operation years 9-13, outlet number 40-99) ☐ 3

Very mature (Operation years over 14, outlet number over 100) ☐ 4

Table 5.6 Frequency and percentage of development stage of international franchising system

| | Frequency | Percentage |
|--------------------------|-----------|------------|
| Gradually getting mature | 80 | 61.5 |
| Very mature | 50 | 38.5 |
| Total | 130 | 100.0 |

Table 5.6 indicates that 38.5 percent of international franchising firms are at gradually getting mature stage when they entered China while 61.5 percent of the firms are at very maturity stage. 80 respondents operated at domestic market for 9 to 13 years, and have 40 to 99 outlets. 50 respondents operated at domestic market over 14 years, and have over 100 outlets. The results show that domestic market saturation and competition are the main factors forced the firm to expand business internationally. This research result consists with the findings of Welch (1990) and Hoffman and Preble (1993). So firms face domestic market saturation and domestic competitive pressure will certainly move to overseas market. The research result also consists with the findings of exploit potential markets by Hackett (1976), Hoffman and Preble (1993), Welch (1990) and Hopkins (1996); increase sales and profits by Trankheim (1979), Kedia et al (1994) and Hopkins (1996); market expansion by Trankheim (1979), Kedia et al (1994) and Eroglu (1992).

5.3.7 International Franchising System's life Cycle

Q7. Please stage the franchising life-cycle of your firm' at the time of entry

into China.

Introduction ☐ 1

Expansion ☐ 2

Maturity ☐ 3

Decline ☐ 4

Table 5.7 Frequency and percentage of international franchising system's life cycle

| | Frequency | Percentage |
|--------------------|-----------|------------|
| Introduction Stage | 50 | 38.5 |
| Expansion Stage | 80 | 61.5 |
| Total | 130 | 100.0 |

Table 5.7 shows that 38.5 percent of the respondents entered China at introduction stage while 61.5 percent of firms are at expansion stage. This indicates that the international franchising firms take the market expansion strategy in order to increase its sales. At this stage, firms have the intentions to expand business and they have the financial ability to do promotion in China. So for international franchising firms at expansion stage is more likely to expand business to other countries and regions.

5.3.8 International Marketing Experience

Q8. Did you have any experience in operating in other countries before entering into China?

A lot of experience ☐ 1

Some experience □ 2

Very little experience □ 3

No experience □ 4

Table 5.8 Frequency and percentage of international marketing experience

| | Frequency | Percentage |
|------------------------|-----------|------------|
| A lot of experience | 10 | 7.7 |
| Some experience | 30 | 23.1 |
| Very little experience | 10 | 7.7 |
| None | 80 | 61.5 |
| Total | 130 | 100.0 |

Table 5.8 shows that when the respondents were asked whether they had operating experience in international markets before entering China, only 7.7 percent said that they had quite a lot of experience, and 30.8 percent declared that they had a little or very little experience, while most of the firms (61.5 percent) indicated they had had no experience in international markets when they entered China. This result implies that international marketing experience has no impact on international franchising firm's market expansion decision in China.

5.3.9 A Relatively Low-cost, Low-control

Q9. Do you agree that franchising is considered to be a relatively low-cost, low-control entry mode choice for international franchising firms to access the Chinese market?

Yes ☐ 1

No ☐ 2

Table 5.9 Frequency and percentage by a relatively low cost and low control

| | Frequency | Percentage |
|-------|-----------|------------|
| Yes | 76 | 58.5 |
| No | 54 | 41.5 |
| Total | 130 | 100.0 |

Table 5.9 shows that when the respondents were asked whether they adopted franchising due to a relatively low-cost and low-control when they decided to enter the Chinese market, 41.5 percent did not agree while 58.5 percent agreed. This result indicates that there is no much different opinion about the low-cost and low-control considered by international franchisors entering the Chinese market. So low-cost and low-control have no much impact on market entry mode choice for international franchising firms entering the Chinese market.

5.3.10 Outlets

Q10. How many total outlets (stores) do you have in China?

Less than 50 ☐ 1

50-200 ☐ 2

200-500 □ 3

500-800 □ 4

Above 800 □ 5

Table 5.10 Frequency by outlets

| | Frequency | Percentage |
|----------------|-----------|------------|
| Less than 50 | 44 | 33.8 |
| 50-200 | 30 | 21.5 |
| 200-500 | 32 | 24.6 |
| 500-1000 | 13 | 10 |
| More than 1000 | 12 | 9.2 |

Table 5.10 shows that 44 international franchising firms have less than 50 outlets, covering 33.8 percent; 30 respondents have 50 to 200 outlets, covering 21.5 percent; 32 have 200 to 500 outlets, covering 24.6 percent; 13 firms have 500 to 1000 outlets, covering 10 percent and 12 firms have over 1000 outlets, covering 9.2 percent.

These data shows that the majority of the international franchising firms entered China is medium and small size enterprises. Only 0.3 percent firms are large firms. This also indicates that there is a potential market for other international franchising firms if they want to enter the Chinese market. On the other hand, it provides some useful data for the author to make comparison with the local franchising firms for future research.

5.3.11 Risk Spreading Consideration

Q11. Do you consider risk spreading when you make your entry strategy

into China?

A lot of consideration ☐ 1

A little consideration ☐ 2

Very little consideration ☐ 3

None ☐ 4

Table 5.11 Frequencies and percentages of risk consideration

| | Frequency | Percentage |
|---------------------------|-----------|------------|
| A lot of consideration | 80 | 61.5 |
| A little consideration | 30 | 23.1 |
| Very little consideration | 10 | 7.7 |
| None | 10 | 7.7 |
| Total | 130 | 100.0 |

Table 5.11 shows that about 84.6 percent of the respondents reported that they considered risk spreading when choosing their entry mode choice into the Chinese market, while 15.4 percent respondents didn't consider or considered very little.

This result indicates that risk spreading is a very important factor influencing the international franchising firms' entry mode choice in the Chinese market. This result does confirm the literature of James and Gary (2003); Anderson (1984); Gastrogiovanni, Justis and Julian (1993). It does not support Harriagn (1988).

5.3.12 GDP Volume of China from 1985-2005

Q12. Do you think of the GDP growth of Chinese economy has some

impacts on your market evaluation of entry decision?

Yes ☐ 1

No ☐ 2

Figure 5.1: GDP Volume of China from 1985-2005

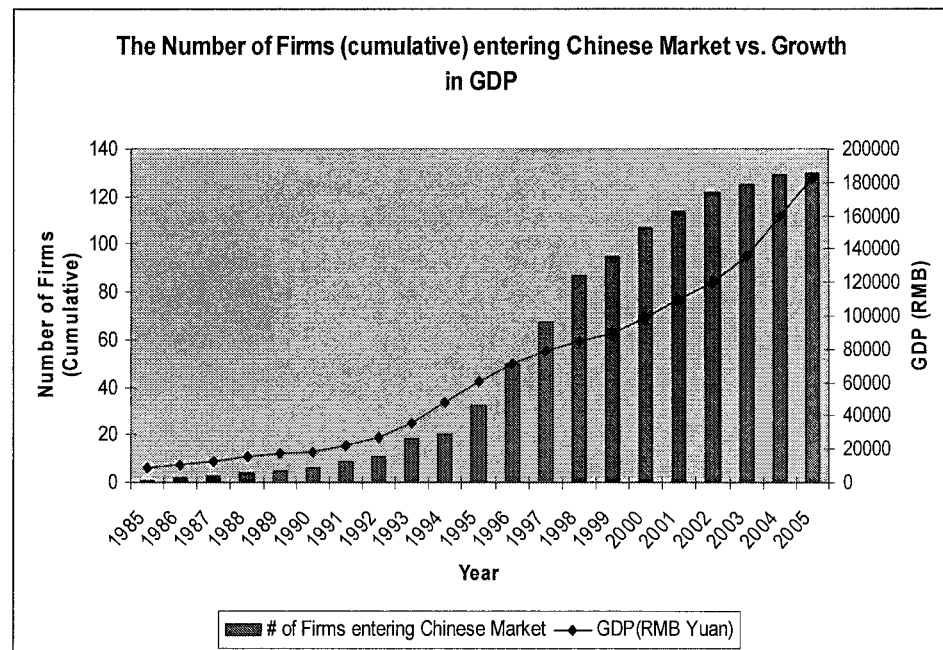


Figure 5.1 indicates that the number of international franchising firms has very close relationship with China's GDP growth.

The income of the citizenry, in particular disposable income, determines whether an adequate market potential exists. A readily available measure which can be used as a proxy for individuals' income is the per capita GDP. Per capita income was positively related to the business expansion of international franchising. The level of economic growth is ranked as very important factor in determining whether a foreign country is likely to be receptive to a franchise system. Eighty-five percent of the international

franchisors rated economic growth as either important or the most important consideration in host country evaluation. This construct can be measured using the rate of GDP growth over a specified number of years. The Chinese economic growth rate has a great impact on the international franchising firms' market entry strategies. The more the Chinese economy grows, the more likely the international franchising firms would enter the Chinese market. Host country economic condition is one of the important factors for international franchising firms to make their entry strategies.

As economic growth rate from 1985-2005 was around 9 percent in China, more and more international franchising firms expand their business to this market simultaneously. 85 percent respondent rated economic growth the most important motivation to enter the Chinese market. The increased disposable income of the citizenry determines the adequate market potential. Continuing Chinese economic growth will attract more international franchising firms to enter into this market. The research result shows that host country economic growth has a great impact on the motivation of international franchising firms. This research result consists with the findings of exploit potential markets by Hackett (1976), Hoffman and Preble's (1993), Welch (1990) and Hopkins's (1996); increase sales and profits by Trankheim (1979), Kedia, Ackerman, Bush and Justis (1994) and Hopkins (1996); perceived favourability of the external environment by Eroglu (1992) and Hoffman and Preble (1993); firm size by Eroglu (1992) and Aydin and Kacker (1990); desire for growth by Walker and Cross (1989), Welsh and Alon, (2001).

5.3.13 Importance of Factors for International Franchising Firm's Entry Mode Choice

Q13. How important do you think the following factors influencing your firm's entry mode choice in China? (Please tick the number, 1 being very important, 5 being unimportant.)

| | VERY IMPORTANT | | | | UNIMPORTANT |
|----------------------------|-------------------|---|---|---|-------------|
| 1. Brand name | 1 | 2 | 3 | 4 | 5 |
| 2. Technical knowledge | 1 | 2 | 3 | 4 | 5 |
| 3. Political uncertainty | 1 | 2 | 3 | 4 | 5 |
| 4. Law and regulations | 1 | 2 | 3 | 4 | 5 |
| 5. Initial investment cost | 1 | 2 | 3 | 4 | 5 |
| 6. Technological change | 1 | 2 | 3 | 4 | 5 |
| 7. Type of product | 1 | 2 | 3 | 4 | 5 |

Respondents were requested to circle a score from 1 (very important) to 5 (unimportant) for aspects of factors influencing their entry mode choice in China. In order to make the results under two circumstances comparable, only those who have experience of other entry mode choice were studied. Therefore, the total number of cases for these questions is 82 instead of 130; 48 cases without indirect experience was filtered out. The results will be interpreted in terms of frequency, mean score and skewness.

The frequency of each item is shown in appendix C. The larger the mean score is, the less important the franchisors consider the factor to be. The skewness for a normal distribution is 0. A negative skewness means that the majority of the scores tend to be 1 or 2, which means the factor under

study is considered important. On the contrary, a positive skewness means that the majority of the scores tend to be 4 or 5, which means that the factor is considered to be unimportant.

When entering the Chinese market, international franchisors consider the factors of brand name; technical knowledge; political uncertainty; law and regulations; and type of product to be most important, as Table 5.12 shows that most respondents chose '1' for these factors. However, the skewness of initial investment cost is 0.127 and political uncertainty is 0.128 (Table 5.12), which means that most respondents tend to believe that these factors significantly influence their entry mode choice in China.

Table 5.12 Importance of factors affecting entry mode choice

| N | BRAND | TECHNICAL | POLITICAL | LAW | COST | CHANGE | PRODUCT |
|------------------------|--------|-----------|-----------|---------|--------|---------|---------|
| Valid | 82 | 82 | 82 | 82 | 82 | 82 | 82 |
| Missing | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Mean | 1.5000 | 2.1707 | 2.5122 | 2.6585 | 2.2683 | 2.5244 | 2.4390 |
| Std.Deviation | .98445 | 1.56981 | 1.18888 | 1.09115 | .95644 | 1.12465 | 1.04347 |
| Skewness | 1.711 | 1.123 | .128 | .546 | .127 | .285 | .834 |
| Std. Error of Skewness | .266 | .266 | .266 | .266 | .266 | .266 | .266 |

It is interesting to see the different importance of factors the international franchisors considering when they make their entry mode choice in China. Initial investment cost and political uncertainty become the most important factors, which have the skewness of 0.127 and 0.128 respectively (Table 5.12). Technique change is still considered to be an influential factor. The skewness data of law and regulation is 0.546; product type is 0.834; technical knowledge is 1.123 and brand is 1.711 respectively, which indicates that law and regulation; product type are attached more

importance when international franchising firms make their entry strategies into China.

Based on the answer to this question, the frequency of the response to each factor is reported in appendix C. It suggests that most franchisors think initial investment cost and political uncertainty are the most important factors affecting firm's entry mode choice in China. A significant proportion of franchisors think law and regulation; product type; technological change and the type of product have important effect on firm's entry model choice, while most firms think brand name is not an important factor affecting entry mode choice in China. (See appendix C)

5.4 Hypotheses Testing: Proportion Difference Tests

In order to investigate the linkage between entry strategy, other entry mode choice versus direct franchising, and the various characteristics of franchising firms, the author will use proportion difference test.

First the author defines an entry strategy variable which is equal to 1 if the firm chooses direct franchising and zero otherwise. Second, the sample firms are divided into different groups according to the different characteristics of firms (the summary statistics of firm characteristics are reported in previous section). Third, mean comparison tests are used to compare the proportion of firms choosing direct franchising (μ) across different groups. For example, assuming there are two groups of firms x and y, which are different in certain characteristics. The proportion of firms choosing direct franchising for group x is μ_x and the one for group y

is μ_y . The null hypothesis is, $\mu_x = \mu_y$, that there is no significant difference in entry strategy between these two groups x and y . The test of $\mu_x = \mu_y$ is given by $t = \frac{\bar{x} - \bar{y}}{(s_x^2/n_x + s_y^2/n_y)^{1/2}}$, where \bar{x}, \bar{y} are sample mean of entry strategy variable for group x and y ; s_x^2, s_y^2 are standard deviation for group x and y ; n_x, n_y are the numbers of firms in group x and y . This statistic is distributed as Student's t . If the t statistics reject the null hypothesis at the 5 percent significance level, the researcher concludes that the groups x and y have different entry strategy.

5.4.1 Relationship between Original Country of Franchising Firms and Entry Modes of Franchising

In order to analyze the relationship between original country of franchising firm location and entry modes, the author conducted the following hypothesis.

H1: The more the culture and geographical distance between the host country and home country, the less likely the international franchisor is to adopt direct franchising entry mode in China.

Table 13 reports the proportion difference test across the firms from Asian countries and Europe. The results suggest that there is a significant relationship between original country location and franchising entry mode.

The Proportion Difference Test shows that the proportion of firms adopting direct franchising in Asian franchising firms is significantly higher than the one in European franchising firms. Both the geographical and cultural distance between China and Asian countries are less than the ones between China and European countries. The more similar the franchisor's country and the target country, the more likely the firm will adopt direct franchising entry mode.

Table 5.13 Relationships between home country and entry strategies

| Proportion Difference Test | P_{Asian} | P_{Europe} | $P_{Asian} - P_{Europe}$ |
|---|-------------|--------------|--------------------------|
| Proportion of Firms Adopting Direct Franchising | 38.8 % | 10.0 % | 0.29** (0.16) |

Note: standard error is reported in parenthesis. ** represents 5 percent significance level.

The evidence suggests that the distance between home country and host country matters for entry model choice. This finding is consistent with the previous studies showing the importance of distance factors in entry mode choice. For example, in the literature review chapter, Anderson and Gatigon (1986) found that cultural diversity between the franchisor and host country, particularly as regards value and method, can create internal uncertainty as well as problems in business conduct. Hofstede (1980) found that national culture gap, particularly Western culture and Eastern culture difference, sharply affect an organisation's management. Taylor, Zhou and Gregory (2000) have shown that East Asian society has different institutional structure than Western nations. When East Asian firms enter overseas markets, culture gap is a considerable factor in weighting foreign market entry decision.

5.4.2 Relationship between Experience and Entry Mode Choice of Franchising

In order to analyze the relationship between experience and entry modes, the author conducted the following hypothesis.

H2: The richer the experience of international franchisors, the more likely the firms is to adopt direct franchising entry mode in China.

The researcher divides the sample firms into two groups: those with some experience, and those with little or no experience. The results of proportion difference test are reported in Table 5.14.

Table 5.14 Relationships between experience and entry strategies

| Proportion Difference Test | | $P_{NoExperience}$ | $P_{Experience}$ | $P_{NoExperience} - P_{Experience}$ |
|---|--|--------------------|------------------|-------------------------------------|
| Proportion of Firms Adopting Direct Franchising | | 36.7 % | 37.5 % | -0.008** (0.09) |

Note: standard error is reported in parenthesis. ** represents 5 percent significance level.

The proportion difference test suggests that there is no significant difference in the proportion of the firms choosing direct franchising between experienced firms and inexperienced firms. This finding is not consistent with Hypothesis 2. However, the limitation of the proportion difference test is that the author didn't control other important factors affecting the entry mode choice. The results are not consistent with the findings of Anderson and Gatignon (1986), Herrman and Datta, (2002), and Whitelock (2002). This result shows that those international franchising firm who have rich experience in direct franchising adopt other entry mode in the Chinese market.

5.4.3 Relationship between Firm's Life Cycle and Entry Strategies

In order to analyze the relationship between franchising system life cycle and entry mode, the author conducted two hypotheses: the first hypothesis is about the life cycle of international franchising firms and the entry strategies, and the second hypothesis is about the maturity of international franchising firms and the entry strategies in China.

H3: The higher the rate of the expansion of the franchising system, the more likely the firms is to adopt direct franchising entry mode in China.

The sample firms are divided into two groups according to their marketing stages: introduction stage and expansion stage. The results of proportion difference test are reported in Table 5.15. The results suggest that the percentage of firms choosing direct franchising in expansion stage is significant higher than the ones in introduction stage.

Table 5.15 Relationships between expansion stages and entry strategy

| Proportion Difference Test | | | $P_{Introduction}$ | $P_{Expansion}$ | $P_{Introduction} - P_{Expansion}$ |
|---|--|--|--------------------|-----------------|------------------------------------|
| Proportion of Firms Adopting Direct Franchising | | | 28.0 % | 42.5 % | -14.5 %** (0.087) |

Note: standard error is reported in parenthesis. ** represents 5 % significance level.

H4: The more mature the international franchising system, the more likely the firms is to adopt direct franchising entry mode in China.

The sample firms are divided into two groups: pre-mature firms (those gradually getting mature), and very mature firms. The results of proportion

difference test are reported in Table 5.16. The results suggest that the percentage of firms choosing direct franchising in mature firms is significant higher than the ones in pre-mature firms.

Table 5.16 Relationships between maturity and entry strategy

| Proportion Difference Test | $P_{Pr\ mature}$ | P_{Mature} | $P_{Pr\ mature} - P_{Mature}$ |
|----------------------------|------------------|--------------|-------------------------------|
| Proportion of Firms | 30.0 % | 48.0 % | -0.18** |
| Adopting Direct | | | (0.086) |
| Franchising | | | |

Note: standard error is reported in parenthesis. ** represents 5 % significance level.

The analysis suggests that the mature firms are more likely to use direct franchising and the firms in expansion stage are more likely to use direct franchising. These findings are consistent with the literature on the linkage between firm life cycle and entry strategy. For example, linking back to literature chapter, the life cycle model of franchising by Oxenfelt and Kelly (1968) suggests that the new company may face the limitation in access to external funds and it tend to adopt other entry mode choice to use franchisee's resources. When the franchisors face less capital constraints and become more familiar with the local market in expansion stage, it may either directly take over the production units from the franchisees or adopt direct franchising. Niu (2001) suggested that a foreign firm normally requires a local partner in the early stages of operations. Multinational Corporations (MNCs) will learn from the operations in the host country market and access more local knowledge. They tend to depend less on the

local partners in the mature stage. Agarwal and Ramaswami (1992) provided empirical evidences that MNCs with more experience in a particular country tend to expand by means of full control mode, as befitting their overall strategic position.

5.4.4 Relationship between Risk Spreading and the International Franchisors' Entry Mode of Choices in China.

In order to analyze the relationship between risk spreading and the international franchising firm's entry mode of choices in China, the author developed the following hypothesis.

H5: The more spreading of risks , the more likely the firms is to adopt direct franchising entry mode in China.

The sample firms are divided into two groups: the firms that considered minimizing the operating risk and the ones didn't consider or considered very little. The results of proportion difference test are reported in Table 5.17. The percentage of firms considering risk is high than the firms that didn't consider the risk. We can see it from Table 5.17.

Table 5.17 Relationships between risk and entry strategy

| Proportion Difference Test | $P_{a_{Norisk}}$ | P_{Risk} | $P_{Noisk} - P_{Risk}$ |
|---|------------------|------------|------------------------|
| Proportion of Firms Adopting Direct Franchising | 25.0 % | 42.2 % | -17.2 %** (0.091) |

Note: standard error is reported in parenthesis. ** represents 5 %significance level.

The finding that risk-averse firms are more likely to adopt direct franchising is consistent with the previous findings that risk consideration

is an important explanation for franchising strategy. James and Gary (2003) argued that franchising allows a risk-averse franchisor to maintain control over profitable units with more certain revenue patterns while shedding “risky” location with uncertain and unpredictable revenues. Faced with rapid technological advances, changing market structures and increasing global competition, firms are motivated to form alliances with other firms to minimize operation and investment risks (Harriagn, 1988). Reasons for a firm to form an alliance with another firm may lie in resource pooling, asset protecting and the ability to react quickly to market changes, but the key reason is risk sharing.

5.4.5 Section Summary

In summary, proportion difference tests show that there is significant difference in entry strategies across different groups. Entry strategies are closely related to home country of the franchising firms, expansion stage and maturity. Except Hypothesis 2, hypothesis 1, 3, 4 and 5 are fully supported by the analysis of proportion difference test.

5.5 Hypotheses Testing: Regression Analysis

5.5.1 The Logit Model

Logistic regression analysis is widely used by international management studies as a method to predict the occurrence of the dependent variable choice (Anderson and Coughlan, 1987; Klein and Roth, 1990; Ramaseshan and Patton, 1994). In order to further examine the effect of firm characteristics on entry strategy of international franchising firms, this

study has adopted this method as a key statistical analysis tool that explains, based on the firm's characteristics, whether a firm decides to choose direct franchising. Specifically, the author estimates the following model:

$$\Pr(Y_i = 1) = F(X_i\beta) = \frac{\exp(X_i\beta)}{1 + \exp(X_i\beta)} \quad (1)$$

Where Y_i is a dummy variable equal to one if firm i choose direct franchising and zero if firms i choose other entry mode choice. X_i measures various characteristics of firms and include the following variables:

- (1) Industry dummy I_{ij} which is equal to 1 if firm i operates in industry j and zero otherwise.
- (2) Entry date dummy variables, D_{1990} and D_{2000} , which measure the entry date of firms. D_{1990} is equal to 1 if the firm entered Chinese market during the 1990s and zero other wise. D_{2000} is equal to 1 if the firm entered Chinese market during the 2000s and zero otherwise. The benchmark is the firms entering China in the 1980s. These dummies control the time effect of entry period.
- (3) Two dummy variables, D_{US} and D_{Europe} , which represent the home country of the international franchising firms. $D_{America}$ is equal to 1 if the firm comes from North America and zero other wise. D_{Europe} is equal to 1 if the firm comes from Europe and zero other wise.
- (4) Brand recognition dummy, D_{Brand} , which is equal to 1 if the brand recognition or reputation of the firm is high (or very high) and zero other wise.

(5) Marketing stage dummy, D_{Stage} , which is equal to 1 if the firm is at the expansion stage and zero if the firm is at the introduction stage.

(6) Maturity dummy, D_{Maturity} , which is equal to 1 if the firm is very mature and zero if the firm is pre-mature (gradually getting mature).

(7) Risk consideration dummy, D_{Risk} , which is equal to 1 if the firm considered minimizing the operating risk when choosing the entry strategy and zero if the firm didn't consider or consider very little.

(8) Experience dummy, $D_{\text{Experience}}$, which is equal to 1 if the firm has a lot of or some experience and zero if the firm has a little or no experience.

The log-likelihood function for logit is

$$LnL = \sum_{Y_i=1} \ln F(X_i\beta) + \sum_{Y_i=0} \ln[1 - F(X_i\beta)] \quad (2)$$

Given this likelihood function, maximum likelihood estimation is used to estimate the coefficient β . The estimated coefficients $\hat{\beta}$ in logit model are reported in following table:

Table 5.18 Determinants of entry strategy of international franchising firms

| | Logit Model |
|-------------------------|---------------------|
| D ₁₉₉₀ | 0.555 (0.74) |
| D ₂₀₀₀ | 0.180 (0.22) |
| D _{America} | -2.972** (-2.10) |
| D _{Europe} | -4.823** (-2.37) |
| D _{Brand} | -0.142 (-0.19) |
| D _{Stage} | 1.718** (2.26) |
| D _{Maturity} | 2.028** (2.33) |
| D _{Risk} | 2.196* (1.81) |
| D _{Experience} | -2.064** (-2.01) |
| Constant | -0.213 (-0.19) |
| Industry Dummies | Yes |
| R-square | 0.11 |
| Observations | 130 |

Note: z-values are reported in parenthesis. * and ** represent 10 percent and 5 percent significance level, respectively.

5.5.2 Comparison of Findings with Earlier Studies

The results of logit model are reported in Table 5.18. The results suggest that the estimated coefficients of time dummies, D₁₉₉₀ and D₂₀₀₀, are statistically insignificant different from zero. This means that entry period has no significant impact on entry mode choice. The estimated coefficients of D_{America} and D_{Europe} are negative and statistically significant. The benchmark is Asian firms. This suggests that Asian firms are more likely to choose direct franchising than the firms coming from North America and Europe. Since Asian countries are closer to China in both cultural and geographical distance, this result is consistent with Hypothesis 1: the more

the culture and geographical distance between home country and host country, the less likely the international franchisors adopt direct franchising in China.

This finding is consistent with the previous studies showing the importance of distance factors in entry mode choice. For example, in the literature review chapter, Anderson and Gatigon (1986) found that cultural diversity between the franchisor and host country, particularly as regards value and method, can create internal uncertainty as well as problems in business conduct. Hofstede (1980) found that national culture gap, particularly Western culture and Eastern culture difference; sharply affect an organisation's management. Taylor, Zhou and Gregory (2000) shown that East Asian society has different institutional structure than Western nations. When East Asian firms enter overseas markets, culture gap is a considerable factor in weighting foreign market entry decision

Table 5.18 shows that the coefficients of brand recognition dummy are insignificant. The estimated coefficient of Stage dummy is 1.718 and significantly different from zero at 5 percent level. This implies that the firms in expansion stage are more likely to choose direct franchising than the firms in introduction stage. The estimated coefficient of Maturity dummy is 2.028 and statistically significant different from zero, which implies that mature firms are more likely to choose direct franchising than the pre-mature firms. Both Stage dummy and Maturity dummy measure the stage in the life cycle of international franchising firms. These results

support Hypothesis 3 and Hypothesis 4 that the mature firms and the firms in the expansion stage are more likely to use direct franchising.

These findings are consistent with the literature on the linkage between firm life cycle and entry strategy. For example, the life cycle model of franchising by Oxenfelt and Kelly (1968) suggests that the new company may face the limitation in access to external funds and it tend to adopt other entry mode choice to use franchisee's resources. When the franchisors face less capital constraints and become more familiar with the local market in expansion stage, it may either directly take over the production units from the franchisees or adopt direct franchising. Niu (2001) suggested that a foreign firm normally requires a local partner in the early stages of operations. MNCs will learn from the operations in the host country market and access more local knowledge. They tend to depend less on the local partners in the mature stage. Agarwal and Ramaswami (1992) provided empirical evidences that MNCs with more experience in a particular country tend to expand by means of full control mode, as befitting their overall strategic position.

Table 5.18 shows that the estimated coefficient of Risk dummy is positive and significant only at 10 percent significance level. Controlling other important factors, risk consideration does not have strong effect on entry mode choice. This result does not support Hypothesis 5 that the franchising firms which consider minimizing the operating risk are less likely to choose direct franchising as the entry strategy.

The estimated coefficient of Experience dummy $D_{\text{Experience}}$ is negative and significant at 5 percent significance level. It supports Hypothesis 2: Foreign market experience has a significant impact on the international franchising firm's market entry strategy.

This finding is consistent with previous studies which found that international experience significantly affected the firm's entry mode. For example, Anderson and Gatigon (1986), Herrman and Datta, (2002) found that the more international experience a firm possesses, the more likely the firm adopts an entry mode with higher level of control. Whitelock (2002) also predicates that international experiential knowledge is a kind of considerable factor in international marketing.

5.6 Open-ended Question Analysis

At the end of the questionnaire, respondents were asked to complete two open-ended questions

Q19. What else factors do you think affecting your entry mode choice in China?

Q20. Please make some suggestions and comments for other international franchisors that plan to enter the Chinese market.

5.6.1 Added Factors Affecting the International Franchising Entry Mode Choice in China

Out of the total of 130 responses, 10 respondents failed to complete the first open-ended question. Reading through the rest of the responses, the

researcher sums up and interprets the feedbacks.

The author sums up the factors affecting the international franchising firms' entry mode choice. They are divided into three groups: external factors; internal factors and culture factors.

External factors:

- 1) Fluctuation in currency exchange
- 2) Inconsistent government policies
- 3) State of the economy
- 4) Protection of trademarks and intellectual property

Internal factors:

- 1) Risk of failure; long time to break-even
- 2) Unsuitable partners
- 3) Monitoring difficulties (distance, communication, linguistics)
- 4) Need to modify products and system
- 5) Cost of monitoring
- 6) Non-transferable experience

Cultural factors

- 1) Management style
- 2) Consumer preferences (tastes; preference for cheaper local products)
- 3) Adaptation of the franchise package

The participants added above 13 factors. This will be very useful for the future research.

5.6.2 Suggestions and Comments for Those who Plan to Enter the Chinese Market in Future

Out of the total of 130 responses, 20 respondents failed to complete the second open-ended question. Reading through the rest of the responses, the researcher sums up and interprets the feedbacks.

The respondents made the following suggestions and comments for those who plan to enter the Chinese market in future.

5.6.2. 1 Development of Localization

Every international franchising brand will face with a process of localization when it begins to expand all over the world; regardless of how successful it has been at home in development and management, especially in the fields where there are big differences between Eastern and Western cultures.

Some franchising firms require their products to be the same as the ones put into domestic market exactly, considering to stick up for the report of brand. But the most important thing is how to get Chinese consumers' acceptance to these foreign products with logical prices. During TOP 20 franchising brands listed in diagram forward, Subway's growth experience in China can be used for reference by many other international franchising firms. Not only by store industry magnates such as McDonald and KFC, but also cabaret chain industry magnates have taken some localization measures in order to make their products more competitive.

To create competitive advantages, international franchising firms must

adopt innovation strategy to avoid competitors using “me too” strategy against them.

5.6.2.2 Differences in Rules of the Game

There are differences in understanding and collecting franchising fees between Chinese and foreign firms. In addition, Chinese investors and firms often are apt to joint-stock form when they are making invest decisions or making choices of invest forms in order to reduce operating risk. It is difficult to ask investors to both pay franchising fee and make capita investment alone at the same time. This kind of differences is the biggest obstacle for international franchising brands that are preparing to enter China.

5.6.2.3 Age of Franchisee

Franchising has been developing very fast in China and does not have a long enough period to be mature; so many investors do not have a deep comprehension of this business format. Their views are narrow and shallow, and they are so anxious to succeed that they can only covet the advantages. Thereby when they become franchising franchisee, and possessing a lack of understanding of the franchisor’s culture and tactical objectives, will destroy the franchising brand and franchising system.

5.6.2.4 Erosion of Fake Foreign Brands

Compared to the more developed western economies, the Chinese economic circumstance is close. Many lags and asymmetry give “fake

foreign brands” direct chance to enter China. At present, many franchising brands of domestic industries hang out excellent chain brands coming from Italy, Netherlands and France. But in fact nearly half of these brands are counterfeit. Franchisees will bear great loss when these “fake foreign brands” are taking cheating actions.

5.7 Chapter Summary

In this chapter, the proportion difference test is used to examine the effect of different firm characteristics on the franchising firms’ entry mode choice. The results suggest that home country of the franchising firms, market stage, maturity and risk spreading are important determinants of entry strategy of international franchising firms in China, while experience does not have significant effect on entry mode choice in China.

In order to enhance understanding of this research topic and invest out how are the findings of the questionnaire apply,, case studies were conducted in the next chapter.

Chapter 6

Case Study Analysis

6.1 Introduction

The purpose of this chapter is to provide more insight to enhance the the understanding of the findings of the out come the questionnaire..

This chapter begins with a profile of researched two companies in this study. It provides data obtained from the case studies to enhance the results of the survey. The analysis is largely based upon managers' feedback who responded to their franchising entry decision making.

Two fast food international franchising firms, KFC and McDonald's, were selected as this industry is at the first place involved by foreign franchisors in the Chinese market. It is believed that these two companies are pioneers among international franchisors in China. It took the author three months to do the cases.

6.2 Case One: Kentucky Fried Chicken (KFC) Case Analysis

The author relied on many years of working relationship to make successful contact with Manager W who was one of the pioneers to work in KFC China at the very beginning of 1987. He provided enthusiastic support towards the author. Another interviewee is Mr S who is now is in

charge of day-to-day working at the moment for Beijing office. They accepted the interview in Manager W's office. This interview was conducted on Nov 13, 2005. It lasted about sixty minutes and was carried out in a friendly manner.

6.2.1 Background of KFC in China

In order to do the interview well, the author got the company background before hand from the second hand information. The author was also allowed to read some of the files of the company.

Kentucky Fried Chicken (KFC)- one of the most known fast food chains in the world started in the early 1930's by Kernel Sanders in the Southern USA as a small franchise operation. Colonel Sanders has become a well known personality throughout thousands of KFC restaurants world wide. Quality, service and cleanliness represent the most critical success factors to KFC's global success (KFC company profile, 2005).

Throughout its 35-year history, the company has gone through several stages and has answered to a legion of corporate parents from Heublein to R.J. Reynolds. The most significant stage was when the enterprise was sold to the American giant, Hubelin International in 1974. Rapid growth throughout the use of franchising together with increased competition from primarily MacDonald's reduced the consistency of the standard of both food and service on the individual franchise level leading to massive decreases in profitability. Together with low Research and Development funding from Hubelin, the division found it difficult to match the

expansion plans of its main competitors. KFC responded to these problems by improving staff training; employ a new manager- Michael Miles capable of managing an effective turnaround strategy. The QSC motto was emphasized on a global level together with slogans such as "We Do Chicken Right". In 1982, Hubelin International was acquired by R.J. Reynolds and Richard Mayer succeeded Miles (KFC company documents,2005)..

When the author asked Manager W to make an introduction about KFC in China as well as his role in KFC's entrance to China, he kindly answered all the questions.

He told the author that:

"KFC is a member of Yum! Brands Inc. and is the first foreign fast food company to enter China. We opened our first outlet in Beijing on November 12, 1987 as a joint venture - 5 full years ahead of McDonald's entry into China. Subsequently we opened a wholly-owned outlet in Shanghai in 1989.

Manager W told the author that he was the Vice President of the Southeast Asia division of KFC in 1986. He used to work in KFC in USA before he came to China. W also told the author that he laid the foundation for KFC to enter China as he had the necessary knowledge and understanding of China and was sufficiently diligent in considering potential partners as well as locations to succeed.

Manager S clarified that:

“Manager W was an experienced entrepreneur as he had a long and productive history at KFC. When KFC decided to enter into the Chinese market, he was recognised as the ideal Zhongjian Ren (The intermediary) as he can speak perfect Mandarin and English. He was as comfortable working in New York as he was in Beijing.”

When the author asked Manager W. to make an introduction about KFC at the time of entry, he was very excited. He said that:

“Western fast food giants like McDonald's and Subway, we are (KFC) in the lead, dominate the fast food market in China. We are able to please the Chinese palate with its 'finger licking good' chicken that is part of the well-established dietary habits of the Chinese. The Chinese, who until the 1980s, were used to untidy restaurants and unfriendly service, have embraced the ambience, rich decors and friendly service of KFC. As of 2003, we had more than 900 outlets, our presence in 12 out of 13 provinces of China. Apart from our popular products, also customised our offerings to suit the Chinese palate such as Peking duck, bamboo soup etc, that helped to win over loyal patrons. We are also the first food chain to introduce a drive-through restaurant in China. Despite heavy competition from Western counterparts like McDonalds and Subway, and China's domestic food chains like Ronghua Chicken, we maintains our lead in the fast food market worth RMB 67.6 (US\$8.1 billion) as of 2002”

6.2.2 Primary Findings of the Interview

6.2.2.1 The Motives of Internationalization of KFC

When the author asked Manager W the motives of KFC entry into China, he replied that opposite to Hubelin International, R.J. Reynolds was

willing to fund KFC's overseas expansion plans. In order to reduce risk, KFC encouraged franchising in complicated markets. This reduced financial risk, but also increased problems of operational control, as local franchisees often were more interested in maximizing profits in the short term rather than to adhere to corporate standards and strategic plans. To find the balance between corporate control and cultural sensitivity has been the main point of concern at KFC.

Manager S identified that:

“Two kinds of factors were regarded as the important motivations by us. They are internal and external factors. The external factors are government policies and supports, plus the competition conditions in the home markets. The internal factors concern the entrepreneurial and strategic aspects from firm’s level. External factors are more important than internal factors.”

He continuously explained to the author:

“On the one hand, the domestic USA market saturation is the first reason for us to expand our business overseas. There are very strong competitors such as McDonald’s and Burger King. On the other hand, China’s open-door policy provided good business opportunity for KFC. Vast country and high potential demand is another motivation for us to enter the Chinese market. China’s FDI policies also provide a favourable condition and create more opportunities for us operating across national boundaries.”

Manager W also declaimed that:

“International franchising provides an opportunity for us to establish a presence in China where the population or per capita spending is not sufficient for a major expansion effort. But Chinese legal and governmental red tape were the major barriers to our entry. In contrast, the large U.S. market, the lack of international management expertise, and limited financial resources are reasons that other franchisors remained domestic. We are favourably predisposed to internationalization. We are likely to pursue international opportunities.”

When the author asked Manager W to make a clarification of their China entry plan, he stated that:

“The China expansion plans first came-up in the early 1980's after several successful expansions in the South East Asian (SEA) region including Japan”

Manager W who was born in China, educated in Taiwan and in the USA, and now living in Singapore was appointed manager for KFC's SEA region. He was given the autonomous responsibility to further investigate the feasibility to further expanding KFC's operations in Asia to the world's most populous nation and the largest market for consumer goods - China. On the other side of the scale, expanding into China would certainly be KFC's most risky international business strategy so far. Moreover, a "go-ahead" signal would make KFC the first western fast-food chain in China.

The potential size and growth of the market in association with improving political stability made the Chinese market very attractive.

According to Manager S, as KFC has already successfully expanded into the Asia, and its products are very popular in the region (large portion of the population is Chinese), It was assumed by KFC that people in China would most certainly find KFC's products attractive. In addition, Manager W explained that the ready access of quality poultry in the major metropolitan areas and host government emphasis on modernization of this industry ensured a reliable supply chain. Opposite to this, potential competitors such as MacDonald's faced major barriers to enter the market due to poor beef supply. Moreover, the Chinese government encouraged the foreign investor involving this market.

6.2.2.2 The Entry Mode Choice of KFC in China

Manager W indicated that the expansion of KFC plans first came-up in the early 1980's after several successful expansions in the South East Asian region including Japan. Manger W identified the entry modes choice of direct franchising and other entry mode choice (wholly owned subsidiary and joint venture). Joint venture was the entry strategy employed by KFC.

Manager W stated that:

“Franchising, KFC's traditional franchising strategy, which is emphasizing standardization and reducing financial risk, on the expense of cultural sensitivity and control. Due to China's strict foreign investment laws such a strategy is not feasible. In addition, KFC is the pioneering in the fast-food field and thus needs to be highly sensitive to cultural demands. In the past, KFC encountered problems with aligning corporate planning with franchisee's short-term focus on profitability. “

Manager S also explained that:

“A wholly owned subsidiary represents the second option. Such a strategy relies upon total control over competitive advantages and ensures complete operational and strategic control. It also involves high investment expenses with no financial risk sharing. With high levels of resource commitment and little country-level flexibility and responsiveness, this option is not recommended by us in China.”

Manager W added that when KFC first entered into the Japanese market in the early 1970's, the company chose to form a joint venture with a large scale poultry producer with excess capacity. This 50/50 joint venture served the two partners very well, as KFC was able to ensure a stable supply of quality supplies to its operations, and the local corporation was able increase efficiencies in production by selling its excess supply. Furthermore, Manager W recalled that KFC was able to utilize existing distribution networks serviced by the partner and at the same time, adhere to exiting rules and regulations imposed by the Japanese government on foreign direct investment.

Manager W stated that:

“Despite of the many differences between the Chinese and the Japanese market, a similar joint venture agreement was highly recommended in China. The essence of a joint venture is the synergy effect of two different entities merging. Such an international business strategy attempted to:

- 1) Solve many logistic problems such as access to good quality chicken and other supplies;*
- 2) Ease the access to the Chinese market;*
- 3) Share risk with a local entity;*
- 4) And finally serve as a sign of commitment to the host government increasing goodwill.”*

In addition, Manager W emphasized that due to the complexity of many barriers to enter into China, a potential partner with sufficient contacts/networks with government agency officials may smoothen the process of setting-up operations in the nation. The potential joint-venture partner should be large, well established, provide excellent distribution channels and have personal network access to government officials. It should also have modern equipment and a good management record. It is recommended that a partner is found by backwards integration, in other words, a good domestic poultry supplier. In order to ensure total commitment and balance of power between the two partners, a 55/45 joint venture (KFC is the dominant partner) was set-up.

Manager S excitedly stated that:

“Joint ventures can solve many logistic problems such as access to good quality chicken and other supplies ease the access to the Chinese market, where the local knowledge of culture, language and geography is beneficial for our entrance into a relatively unknown market. In addition, due to the complexity of many barriers to entry into China, a potential joint venture partner with sufficient contacts (guanxi) with government agency officials makes the process of setting-up operations in the nation more easily. Typically a new entrant would find it very difficulty to form local and personal networks between businesses and government agencies, which are crucial to success and provide access to the local market and domestic suppliers in China.”

Manager W added that:

“Franchising emphasizes standardization and reduces financial risk as well as the expense of cultural sensitivity. Control was not feasible in case of China due to the country's strict foreign investment laws. Furthermore wholly owned subsidiary relies upon total control over competitive advantages and ensures complete operational and strategic control.”

Manager W also had experience negotiating with the Chinese. At first KFC began to look at the location and finally they decided to open operations in Beijing. The reason of choosing Beijing as the first target market was of Beijing's high amount of tourists and its autonomous municipal government. They also thought that if they received approval from the central government they would be able to enter the rest of the Chinese market without a hassle. However, because of the higher profile, the

government might decide that they would not fit into the Chinese landscape, which would prevent them from ever succeeding. Therefore they were aware of importance of establishing a joint venture with a local partner who could provide existing facilities, knowledge of the local government and can penetrate the Chinese system enough to move critical regulatory decisions moving forward.

Manager W explained that:

“WE formed a partnership with the Beijing Corporation of Animal Production who helped us to find a chicken supplier. However we lacked close contact with the government agencies that would be essential to setting up operations. So a third partner was needed and the Beijing Tourist Bureau was chosen to be the ideal partner as they were responsible for the supervision of the construction and operation of all hotels and restaurants in Beijing. After the Beijing Corporation and the Beijing Tourist Bureau became part of the venture, we were able to get the necessary license from the city, allowing us to operate in Beijing. This approval usually takes years as this requires the signatures from different governmental departments, however the Tourist Bureau had the necessary “connection” with the government agencies and they played an integral role in speeding up the application.”

On account of the license, KFC was finally able to open their first outlet and successfully joined the great Chinese markets.

6.2.2.3 Key Factors Influencing KFC Entry Mode Choice

This section turns to what factors influenced KFC market entry mode choices. After initial entry mode was discovered, the participants were further asked to answer why KFC chose the particular entry mode when

they first entered the Chinese market. Driving from the data analysis, the findings revealed some factors.

By asking the participant to decide what factors led to KFC's selection of joint venture entry mode, Manager W replied that:

“By building on each partner's core competencies, knowledge, and efficiencies, a mutually beneficial synergy effect could be achieved as a result of joint venture activities. For instance, the local partner could learn from KFC how to produce a better product at a lower cost and further expand on its new competitive positioning. KFC, on the other hand, can maintain quality supply which was detrimental to its success.”

He also added that:

“A joint venture is also significantly ease the entry to the virgin Chinese market. A new entrant would find it very difficulty to form local and personal networks between businesses and government agencies, which are crucial to success and provide access to the local market and domestic suppliers.

In addition, local business customs and laws can be quicker understood and established ways to cut bureaucratic red-tape can be further utilized. Also, the local knowledge of culture, language and geography is beneficial for any foreign entrant into a relatively unknown market.”

Furthermore, Manager S explained that:

“In order to cope with the significant political risk of investing in China, a local joint venture partner will share this risk. There is always a risk of domestication measures imposed by the host government, often leading to major financial losses for the foreign investor. By having a 55/45 joint venture agreement, this risk is potential eliminated, since only 55 percent of operations are domesticated. If such an unfavorable situation would arise, we clearly have less to loose in such an agreement. In addition, by being the dominant partner, we will be able to ensure cost, quality and strategic control measures.”

According to Manager W, the Chinese government might realized that as the pioneering western fast-food outlet, KFC would benefit to the nation. Training the joint venture partner, personnel and other institutions in the value chain could reduce learning and experience curves. KFC's operations might also inspire local competitors to improve their services and quality of food. Meanwhile, it could also create a competitive environment for fast-food industry in China since many domestic competitors have to respond to KFC's business model and management ideas.

Manager W Specially addressed that:

“A joint venture agreement commonly produces goodwill and commitment between the Chinese government and us. In such a relationship, we are not seen as trying to take advantage of the nation for profit purposes, but rather show willingness to share. Maintaining good relations with the Chinese government is a critical success factor as Chinese government policy impacts intensely upon business activities.”

Manager W's responses reflected that in a foreign market with high political risk and low cultural knowledge, a high degree of cultural

sensitivity was crucial. Centralized control cannot be maintained since it was impossible to effectively manage an overseas operation from the headquarters without the information and knowledge needed to make sound strategic decisions.

6.2.2.4 KFC's Performance in China

Manager W was much excited about the first recommendation of location of KFC. When the author asked W why KFC did not choose Tianjin even if KFC had developed "excellent contacts" with the government of Tianjin, Manager W responded that:

"The poor supply of good quality poultry and the geographic location does not attract too many Westerners that are able to bring-in foreign currency, which is crucially needed to ensure profitability."

Manager W further added that:

“Instead, the Chinese capital city, Beijing was recommended as the preferred location for KFC's entry into the Chinese market. Beijing is the center for most political activity and provides the necessary access to government agencies and business regulatory bodies. Furthermore, it has a large population of nearly 9 million inhabitants. The numerous universities located in the city further educates people that may make them more open to foreign ideas perhaps including western fast-food. More importantly, plenty of western tourists are attracted to Beijing's many tourist attractions, increasing the potential for generating foreign currency sales. Also, suppliers of poultry are available. Beijing can serve as the initial platform of KFC's operations and later expand into other potential areas such as Shanghai and Guangzhou.”

One or two initial outlets should be set up in order to get a "taste" of how KFC would be perceived in the Chinese Capital. Both dine-in and take-out facilities, much in line with most of KFC's international operations ought to be offered in large, clean and well serviced company owned outlets to cater for the customers with above average disposable incomes.

In order to ensure the right cultural fit of the business, manager W emphasized that restaurants must be highly functional and effective in order to serve large numbers of customers due to the sheer size of the population. Special menu-substitutions might also have to be facilitated, such as substituting rice for French-fries.

Manager W consistently confirmed that:

“Since opening our first mainland outlet in Beijing, the fried-chicken chain has gone on to become the most recognized global brand among urban consumers in China. Kentucky Fried Chicken has more than 1510 outlets in China compared to less than 750 outlets for McDonald’s.

Chinese consumers' general preference for KFC outlets and products are much over McDonald's. One of the main reasons behind this is that chicken is already familiar in China and much cheaper and more widely available than beef. Furthermore chicken has long been regarded as a kind of nutritious food which is especially good for the patients, the elders and children. Therefore more health conscious consumers prefer the consumption of chicken over beef. It took us 9 years (till 1996) to set up 100 KFC chain restaurants in China, while it only took 11 months for us to increase the number from 400 to 500 restaurants in the country in 1997. Now, we have presence in almost all major cities in China, and in some smaller cities too. We changed joint venture entry mode into direct franchising and master franchising in 1990.”

Manager W was very excited talking about KFC's good entry strategy. He further stressed that:

“Our triumph could be attributed to our first-mover advantage. There was no fast-food restaurants anywhere on the mainland when the company's initial outlet opened in Beijing in 1987 compared to McDonald's which debuted in Shenzhen in 1990 and came to Beijing in 1992. In the initial period of KFC's entry into China market, few of Chinese consumers were really impressed with the food itself. Instead, they were more fascinated with the eating experience: the encounter with friendly employees, quick service, spotless floors, climate-controlled and brightly-lit dining areas, and smiling Colonel Sanders standing in front of the main gate.

Having experienced the initial surprises brought by a never-seen Western lifestyle, Chinese consumers have gradually calmed down and their consumption attitudes towards foreign products are getting more reasonable.'

In addition, Manager S explained that the success of KFC in China can be attributed to its franchise policy and scientific managerial operations, well known as CHAMPS, which measures operational basics like Cleanliness, Hospitality, Accuracy, Maintenance, Product Quality and Speed. Moreover, KFC's comprehensive understanding of Chinese culture, the achievements of its keen perception of cross-cultural marketing and its excellent localization strategies also contributed to their success story.

Manager S confirmed that KFC has adapted its advertising campaign to suit local preferences, including a Cantonese version of "We do chicken right" advertisements. However, the company also made some early missteps: for example, he recalled that KFC's advertising slogan "finger-licking good" was mistranslated into Chinese characters that meant "eat your fingers off."

To meet consumers' desire for freshness and to satisfy young consumers who are more open and acceptable to the foreign flavours, manager W told the author that KFC introduced western style products such as Mexican Chicken Wrap and New Orleans Barbeque Wings. In addition, more Chinese style fast food, say, Old Beijing Chicken Roll, and Chinese style breakfast food have been offered since year 2003 to cater to consumers' taste for traditional Chinese meal. This measure can attract older

consumers who prefer Chinese food and in need of the convenience of fast food service as well.

Manager S identified that in order to represent the Chinese characteristics and increase the identification from Chinese consumers, KFC absorbs Chinese cultural elements into the arrangements and decorations of its outlets all over China. In 2003, KFC spent RMB7.6 million Yuan (equal to US\$ 900,000) to redecorate the flagship outlet in Beijing which is also the world's largest KFC outlet, with the Great Wall, shadowgraph Chinese kites and other traditional Chinese symbols. KFC's commercials are also designed to present a declining traditional art and attaches pop culture elements with it to integrate Chinese traditional culture into the modern pop culture.

Moreover, Manager S emphasized that some of KFC's commercials also represent certain Chinese traditional cultural values. For a culture awareness,, most Asian families prefer to have boys rather than girls. This can be explained by the dominance of agricultural economy for thousand of years and the one child policy. Most children are the apple of their parent's eyes as they are their parent's only child and are wither known as "little emperors" or "little princesses". In KFC's commercials which depict children are all boys as it better suits the traditional expectation of a Chinese family: a pair of parents and one boy.

Manager S explained that as Chinese per capita income has risen and fertility declined, Chinese parent's love and money have focused on a single child. To meet the requirements of parent's expectation on children

KFC has taken a series of measures such as promoting the KFC kid package which claims the rich nutrition necessary to children's development. Exclusive regions with toys can be found in any KFC outlet in China. Employees would take care of the children on the playground so parents can concentrate on their own meal. At specific time in a day female employees would teach children present to dance or sing English songs.

Localization strategies in China are highly concentrated on children because KFC is well ware of the fact that many of Chinese families visit fast-food restaurants to please their children. In China, when it comes to eating out, children, "little emperors" or "little princesses", are basically the decision makers.

6.3 Case Study Two: McDonald's Case Analysis

As the major competitor of KFC, McDonald's was selected as the second target case study. The following is the findings of the author's interview with General Manager L from McDonald's. This interview was conducted in Beijing, Manager L's office on Dec 20, 2005.

6.3.1 Background of McDonald's in China

McDonald's Corporation (NYSE:MCD) is the world's largest fast food chain, selling primarily hamburgers, chicken, French fries and carbonated drinks, and more recently salads, fruit and carrot sticks. The business was founded in 1940 with a restaurant opened by siblings Dick and Mac McDonald. It was their introduction of the "Speed Service System" in

1948 that established the principles of the fast-food restaurant. However, the company today dates its "founding" to the opening of CEO Ray Kroc's first franchised restaurant, the company's ninth, in 1955. He opened his first McDonald's in Des Plaines, Illinois in April 1955 (Adopted from company website).

In 1990, McDonald's opened its first store in Shenzhen in China, and from then on, for more than 10 years, the McDonald's huge "McDonald's" arches have been in all the cities of China and the number of its outlet has reached more than 750. McDonald's intrudes into Chinese people's stomachs and thoughts, and even affects the traditional oriental diet structure with his golden chips, refreshing taste of Coca-Cola and delicious big Mac.

The milestone of McDonald's first landing on China in 1990, McDonald's Chinese route began from Shenzhen – the richest, most open, most developed and the most dynamic city at that time in China. On the first opening day of Shenzhen McDonald's, thousands of consumers came with their family to share the joy; then in April 1992 at Wangfujing Street in Beijing, the world's largest McDonald's store at the time was opened. The number of transactions on that day was more than 10,000. Since 1992, McDonald's in China has been developing rapidly. In February 1993, the first McDonald's store of Guangzhou was opened in Guangdong International Building, and the transactions of that day broke the world record of McDonald's. In June 1994, the first McDonald's store of Tianjin

was opened on Binjiang Road; July 1994. Shanghai's first McDonald's store was opened in Huaihai Road. 10 years past, more than 750 McDonald's units have sprung up all over China (adopted from McDonald's company file).

6.3.2 The Motives of McDonald's in China

One of the interview questions the author asked the Manager L from McDonald's was why their company decided to enter the Chinese market.

Manager L recalled that:

“The major motive for McDonald's to move into the Chinese market was a desire to take advantage of markets with great potential and to establish a brand name. We are able to enter overseas markets without any change in our marketing strategy and experienced the same level of profitability as we did at home.”

From what Manager L explained; it was identified that unifying the franchisees can raise more advertising fund, thereby strengthening their advertising efforts. This kind of practice creates conditions for the franchisees to show their own talents, and endless good marketing strategies are put forth, which have done so much for the promotion of McDonald's brand value in other countries. Since McDonald's entered the Chinese market, it has achieved huge success and created a brilliant chapter of franchising. Clearly, the motive of McDonald's entering the Chinese market is very straight and clear: the huge market size in China and establishing their brand name internationally.

6.3.3 Entry Mode Choice of McDonald's in China

When the author asked Manager L about the entry mode choice about McDonald's in China, he told the author that McDonald's owned 9,405 restaurants globally or 29 percent of a total 32,065 outlets. The remaining units are run by franchisees and independent operators who use their own money to fund the businesses and pay McDonald's royalties. In the region comprising the Asia Pacific, Middle East and Africa, McDonald's has 2,616 franchised stores of a total of 7,822 outlets. In the U.S., 11,007 out of 13,774 stores are franchised. In Europe, 3,756 out of 6,403 are franchised, and in Latin America, 477 out of 1,656 are franchised. McDonald's has more than 30,000 stores all over the world, of which 75 percent are franchised. As one of the world's most successful franchisor, McDonald's accumulated much valuable experience in the process of franchising.

Referring to McDonald's entry strategies in China, Manager L identified that:

“About 65 percent of our China outlets are wholly owned, with the remainder operated through joint ventures.”

Manager L was very proud and well-intentioned that McDonald's opened its first store in Shenzhen. McDonald's dominated the world as the representative of the culture of Western fast-food. But in the face of deep-rooted traditional Chinese diet and the worldwide equally strong

Chinese cuisine, it was not sure that it can conquer the Chinese people's stomachs. Shenzhen was the window of China open to the world. It had a prosperous economy and the similar way of life to its neighbour Hong Kong, and it was relatively more westernized, people there are so easier to accept new things comparing other Chinese people from the inland cities in China. Particularly because of the fast pace of life in Shenzhen, McDonald's believed that its fast-food culture would soon be accepted by this young city. After the success in such a city, McDonald's gradually developed to infiltrate into all parts of China. Manager L believed that compared to the prudence of McDonald's, KFC—the old competitor of McDonald's—was much more decisive. KFC opened its first store in the political and cultural centre of China—Beijing, which is also the capital of China. In the early years of McDonald's entrance of China, it showed a cautious style, and this characteristic became even more noticeable in its franchise operating afterwards.

Manager L added that:

“We're a franchise company and the long-term vision is franchising in China. But we want to continue to refine McDonald's China before we set up a franchising model.”

In terms of franchising entry mode choices of McDonald's, Manager L admitted that from their experience and performance, he believed that the entry strategy they adopted in Chinese markets are suitable and effective.

6.3.4 Influencing Factors of Entry Mode

When the author asked Manager L what reasons made the embodiment of McDonald's caution, and what were the reasons that made McDonald's so timid and hesitant? Why McDonald's in China had never developed franchising business? He replied that:

“One reason is that we do not purchase real estate any more in China”.

Manager L also stated that

“As China was lack of relevant laws and disciplines about commercial franchise, we were very prudent on the way of franchising. In November 1997 the then Ministry of Internal Trade issued Interim Measures on the Administration of Commercial Franchise Operations (Trial Implementation) which created the first regulatory framework for franchising in China”

Manager L confirmed that from a Western perspective the 1997 Interim Franchise Measures were not particularly sophisticated. In effect they described how franchising works rather than setting out a comprehensive regulatory regime for franchising. But, in the context of a system in which activity which is not expressly authorized is, by implication, prohibited the Measures, despite being administrative rules of a general nature, had a significant role in the official recognition and, by implication, encouragement of franchising as a distinct method of business operation.

Manager L expressed their concerns when considering entering the

Chinese market by stating that:

“The two key areas for consideration by foreign franchisors are intellectual property law and contract law.”

Manager L further indicated that China’s IP laws are becoming increasingly sophisticated and familiar but enforcement remains a real problem. China grants trademarks on a “first-to-register” basis. Therefore, it is imperative that a franchisor considering establishing a franchise in China registers its trademark with the relevant Chinese authority as the first step in any franchising plans for China. A failure to do so can have devastating consequences. Similarly, it is important for a franchisor to take steps to protect its copyright in operations manuals and other written material by educating its franchisees (and all employees of the franchise operation) on the need to keep copyrighted material that contains trade secrets confidential. Franchisors should also register their trademarks and trade names as domain names.

Manager L stressed that:

“There was no any law and regulation about franchising before 1997. From our perspective the 1997 Interim Franchise Measures were not particularly sophisticated. In effect it described how franchising works rather than setting out a comprehensive regulatory regime for franchising. But, in the context of a system in which activity which is not expressly authorized is, by implication, prohibited the Measures, despite being administrative rules of a general nature, had a significant role in the official recognition and, by implication, encouragement of franchising as a distinct method of business operation.”

This is one of the most important reasons that McDonald's adopted the entry mode of others rather than direct franchising.

Manager L confirmed another factor influencing McDonald's market entry strategy in China. He claimed that:

"The oriental, especially most of Chinese have boss complex, while franchising provides only a limited space for franchisees. In this cultural atmosphere, the soil for franchising in China is not as fertile as imagined."

Manager L confirmed that:

"The biggest challenge is the management of franchisees and its brand. If the threshold is too high, it is difficult to advance, but if the threshold is too low, the business will easily go wrong."

Manager L further explained that:

"In order to expand market demand in the Chinese market, in 2002 we announced that the franchisees should at least meet the following demands: noble conduct; first time in the market; awareness of the target market culture and customs; full time to put into McDonald's business development; willing to accept a period of about 12 months of training; having management experience; qualified to work in the franchising organizations; investment an amount not less than UD \$0.3 million."

The number of candidates who meet these demands is rare in China. McDonald's is looking for "the person in whom tomato ketchup flows in the blood", according to Manager L, "McDonald's takes a step forward on

the road of direct franchising rather than other entry mode choice in China”.

Since announcing the requirement for joining the system in 2002, McDonald's began to prepare for the first franchisee. In 2003, McDonald's chose an investor in Tianjin from more than 1,000 applicants who took the initiative to apply in 2002. The first franchisee McDonald's selected in China is a young female Sun Mengmeng. She had received high education and used to study in Canada, and also previously worked for state-owned enterprises. After McDonald's strict requirements of full-time training and assessment for more than one year, Sun Mengmeng was finally allowed to become a franchisee. Now, this Tianjin McDonald's, which is the first McDonald's franchisee in China, is still in operation. However, it was 10 years late since KFC authorized its first franchisee in Xi'an in 1993.

Clearly, McDonald's was far behind on the way of expansion through direct franchising. Regarding this point, Manager L specially identified that

“In addition, we have no intention to franchise more units which is extensively accepted in the U.S.A, which first open company ownership stores, operating them to certain stage and then continue to operate by way of franchising. That is what KFC implemented after 2000 - “Franchise not starting from scratch” is mainly to help reduce difficulties and low risks.”

6.3.5 McDonald's Performance in China

6.3.5.1 McDonald's Localization Strategy in China

In one of the interview questions, the interviewee was asked how he evaluated their performance in China. According to Manager L's explanation, it is found that the tactic of McDonald's localization is cooking one China edition of the U.S.A. culture. So, McDonald is "in the connection of globalization and localization". McDonald is inheriting the business principles of "Quality, Service, Cleanness and Value" , and meanwhile, it insists on the concept that setting up a perfect food supply network system and human resource management and training should develop, progress and prosperous together with local economy.

Manager L commented that:

"The experience of us in Beijing is a classical case of localization. There is a new trend at present in China that absorbs external culture and turning it into local customs. In fact, the localization of McDonald's originally can not be a one-way process."

Manager L emphasized that in the USA, people eat cheap food, enjoy fast serves in McDonald's, which saves time and money. Nevertheless, in Beijing, on the contrary, the big Mac turns into a kind of exquisite diet rapidly and McDonald's becomes such a place: The one only have a meal there can obtain the social status symbol. McDonald's American style has been changed. It is obvious that Beijing McDonald's stores have been transformed into a large middle-class family house, where they can relax.

In this sense, McDonald's has really experienced a process of localization in China, and it represents the Chinese edition of the localization of American goods.

6.3.5.2 Operating Performance: a Tortuous Development

Regarding McDonald's performance in Chinese market, Manager L recalled their historical development. McDonald's operation in China is tortuous. Its operating performance is inseparable to its competition with KFC. McDonald's took the lead at the beginning of their race. In 1999, there were 370 McDonald's stores in 14 provinces, municipalities and autonomous regions; by 2005 the business spread to 27 provinces, municipalities and autonomous regions, and the number of the stores increased by 29 percent to more than 560. But KFC caught up from behind. In January 2004, the store at Yinghuayuan East Street of Chao Yang District Beijing opened. At this point the outlets of KFC in China reached 1400. McDonald's was temporarily behind.

Meanwhile, the rapid pace of McDonald's global expansion resulted in the reduction of service quality and customer satisfaction, making its market share fall but not rise. In November 2002, McDonald's decided to close a total of 175 poor operated chain stores in 10 countries, globally eliminated 400-600 staff members, and withdrew from three countries' markets in Middle East, Latin America and other regions. Its stock price in New York Stock Exchange decreased accordingly. McDonald's Chinese market was not subject to the impact of the global depression, but it suffered serious

brand crisis in 2003. Firstly, in June 2003 its prices-rising resulted in questions from all over the country; then in Guangzhou McDonald's there had an incident that one customer's tea turned out to be germicide; finally, in Hong Kong a "barbecue honey" flavoured condiment launched by McDonald's was suspected of containing stevioside, which might cause cancer if people eat it for a long time, so the condiment was given up. Faced with this unfavourable situation, McDonald's adjusted its global strategy, launched a series of the above-mentioned "I'm loving it" global promotional activities, and invited Yao Ming as its new image spokesmen, trying to reshape its healthy, vital and friendly image. This series of performances were expected to save the situation.

To boost sales, McDonald's strategy has been to focus on selling beef in China and to open more 24-hour restaurants in the country.

Manger L added that:

"Many times, people asked if we are localizing and developing Chinese food. But we realized Chinese consumers do not want us to be another Chinese restaurant. We're a hamburger company."

Another strategy of McDonald's is to increase the number of 24-hour outlets from 240 currently in China, as people don't stop moving around at 11 o'clock at night.

McDonald's is partnered with China Petroleum and Chemical Corp., or Sinopec, and will open 30 drive-through outlets at Sinopec gas stations. All the drive-through restaurants will be open for 24 hours a day.

6.4 Comparison of Cross-case Studies

According to Yin's (2003) case study method suggestion, after each case analysis, the next step is to shift cross-case analysis, and see what common topic they have; how they relate to each other; and how they can achieve research objectives. It is based on the holistic-content perspective, the cross case analysis focus on the motivations, influencing factors and entry mode choices.

By providing direct evidence from the data, the key findings and discussions of this research are presented by exploring 1) the motives of the managers outward investments; 2) influencing factors; 3) Factors' impact on the managers' entry mode choices.

6.4.1 Motivations of Entering China

In each case, the details of findings regarding motivations of two fast food companies entering Chinese market are discussed. By summarizing the research findings, the results were compared with the survey outcomes. It was found that some findings of the survey are supported. However, others were against. The details of the findings are summarized as bellow (see Table 6.1)

Table 6.1 Motivations

| Factors Cases | Political stability | Government support | Establish a brand name | Competition conditions in the home markets | Domestic market saturation | Potential market | Rich experience | Risk spreading |
|--------------------------|--------------------------------|-------------------------------|-----------------------------------|---|---|-----------------------------|----------------------------|---------------------------|
| Case one | Support | Support | Support | Support | Support | Support | Against | Support |
| Case two | Support | Support | Support | Support | Support | Support | Against | Support |

The above analysis reveals that there are many different reasons why franchising firms expand their business internationally. A variety of external and internal factors contribute to firms' motives for entering the Chinese market. As per the above referenced table, there are six different motivations which emerged from the two case studies:

- (1) Political stability,
- (2) Government support,
- (3) Establishment of a brand name,
- (4) Competitive conditions in the home markets,
- (5) Domestic market saturation,
- (6) Potential market opportunities,

are the motives derived from the interview. Most of them support the findings of the survey conducted in the earlier stage. if the research does, however, it is reveal that some of the survey findings may not applicable to every case. A comprehensive investigation is necessary to fully understand this research topic.

In Chapter Two, motives of internationalization based on the international franchising firms from Western developed countries are discussed. In that

chapter, the author argued that motives of international franchising managers' franchising from developed country to China have not been properly investigated. To fill this gap, throughout analyzing and interpreting interview data based on three managers' individual entry decision making experience, the findings based on the empirical results reveal that political stability, government support, establish a brand name, competition conditions in the home markets, domestic market saturation, potential market are the motives of international franchising managers entering China market. Among outcomes of these motives, most of the factors are similar to the motives discovered in the past research. However, some of them did not appear in the case of international franchising firm managers' in China. Rich experience is not the same as in other countries.

All respondents think that the Chinese open door policy plays an important role in stimulating international franchising managers' determinations of going to this market. China is following a unique path to adopt market-oriented economic policies. The vast population and huge consumer market are also motives for these firms to do franchising in China. Moreover, fierce competitions in USA emerged as another force which pushed international franchising firm managers to look for opportunities in China. As one of the pulling factors, the Chinese government support was crucial in determining franchising firm managers' entering country. It is also evident that domestic market saturation has immense value to the understanding of franchising firm managers' motivations of internationalization.

However, whatever the ‘internal factors’ or ‘external factors’, it alone may not be sufficient to persuade US franchising firm managers to invest in China. A company may lose markets in its home country, but might still decide not moving to international markets. With clear strategic objectives, for some international franchising firm managers, moving into the Chinese market was for searching potential market and absorbing information in this country. Others strategically wanted to expand market for a long-term commitment and prepare them for further international investments.

In summary, some classic motives of internationalization discovered in previous research, such as to secure raw materials and seek low-cost labour and materials in host country, appeared as indicators in the case of two managers entering the Chinese markets. This implied that mainstream theoretical literature, which is largely and exclusively derived from international franchising firms in China, can be applied into other emerging countries.

6.4.2 The Entry Mode Choice

Two major entry modes have been identified from the two investigated cases: direct franchising and joint venture. Details of KFC and McDonald’s entry mode choices in China are summarised as follows (See Table 6.2)

Table 6.2: The entry Mode choice

| Entry mode Case | Direct Franchising | Others |
|----------------------------------|---------------------------|---|
| KFC | 32 out of 1700 outlets | Joint venture |
| McDonald's | 1 out of 750 outlets | 65 percent wholly owned remainder joint ventures |

Above table shows that KFC did not adopted direct franchising entry mode in the Chinese market when entered this market. Later on only a small proportion was directly franchised as it concerns more about the culture and geographic distance. But it did not take risk into consideration. This case result does confirm the tested hypotheses 1, 3 and 4. It does not confirm hypotheses 2 and 5.

McDonald's did not adopted direct franchising entry mode in the Chinese market either when entered this market. Till now it still adopts joint venture as it concerns more about the culture and geographic distance. On the other hand, McDonald's did not face financial problem. If a firm is short of capital, it can get financial support through direct franchising. McDonald's also wanted to control the profit.

6.4.3 Influencing Factors

By examining the influencing factors derived from the two case studies, the findings show that 7 different factors are emerged. The results in relations to influencing factors derived from the two cases are compared with the results of the survey, the comparison are listed in Table 6.3.

Table 6.3 Factors Influencing Entry Mode

| Factor \ Case | KFC | McDonald's |
|-------------------------------|------------|-------------------|
| Cultural Distance | Positive | Positive |
| Risk Spreading | Positive | Negative |
| Experience | Negative | Negative |
| Firm Development Stage | Positive | Positive |
| Firm Life Cycles | Positive | Positive |

From the table it can be seen that both firms have taken culture and geographic distance into consideration when they made their market entry choice. They both chose joint venture in China other than direct franchising in other countries. As identified in the survey, culture and geographic distance have great impact on the entry mode choice. The findings of the case show that McDonald's adopts other entry strategy into China market other than direct entry mode as in other countries and regions. The franchisors from America concert of cultural and geographic

distances when they make their entry strategies of international franchisors in the Chinese market.

The author also found out in this case that although McDonald's entered Chinese market at very early stage in 1992, it has less outlets compared to KFC. The reason is that they care much about culture distance between the Chinese and Americans. It adopts joint venture in Chinese market other than direct franchising entry mode as in other countries and regions. The result supports Hypothesis 1.

Experience in these two investigated cases did not emerge as an influencing factor in relation to their entry mode choices. Although KFC and McDonald's had very rich marketing experience, they adopted joint venture other than direct franchising. Experience has no much relation to entry mode choice in the Chinese market. This result does not support Hypothesis 2.

The both cases reveal that they did take risk into consideration in deciding their entry mode choices, but they did not adopt direct franchising entry mode. The Chinese market represents a great opportunity for KFC, but also significant risk. So KFC began operations first in Beijing and later expand into other metropolitan areas. By finding an appropriate domestic business partner via backwards integration, it was possible to further build on opportunities and significantly reduce risk throughout financial sharing, cultural sensitivity, and favourably treatment from the Chinese government. Manager W really played an important role in finding the right joint

venture partner and developed a coherent international strategy linking the China operations with other markets.

Literature shows international franchising firms are likely to adopt direct franchising in order to spread risk with franchisees. But from the case study, different conclusions from the literature have been found. Both firms adopted joint venture entry mode. The result show negative and does not confirm Hypothesis 5.

The case findings reveals that firm's life cycle has positive relationship with entry strategies. McDonald's starts to change its entry mode from joint venture to direct franchising gradually as its system is getting mature and mature. This supports Hypothesis 3 and 4.

6.5 Chapter Summary

This chapter studied the motives, entry mode choice and influencing factors. The case results mostly support the tested hypothesis in Chapter 5. The findings in this chapter offered an insight into how foreign franchisors chose their entry modes when entering the Chinese markets. Based on the two invested large fast food companies, it was found that America franchising firms more likely to adopt joint venture entry modes into the Chinese market, because culture and geographic distance, firms' life cycles, and firm development stage have positive impacts on their market entry mode choice. Experience and risk spreading do not have much relation with the entry mode choice. Almost all the research results from the case

study support the survey results.

Chapter 7

Conclusion and Contributions

7.1 Introduction

This chapter concludes the research on the determinants of international franchising entry modes in China. Section 7.2 is the conclusion. It summarizes the research question, research methodologies and main findings of this thesis. It also sets up a framework of factors influencing international franchisor's entry mode choices in China. Section 7.3 describes the contributions of this study to literature and the implications for the practice of international franchising firms in China. Section 7.4 discusses the limitations of this study and the possible future extension. In Section 7.5, the author reflects on her intellectual journey and research process. Moreover, as an important element of this DBA thesis, evidence of personal professional development and reflective practices throughout this intellectual journey are finally explored by considering successes and challenges and difficulties in completion of this DBA research journey.

7.2 Conclusions

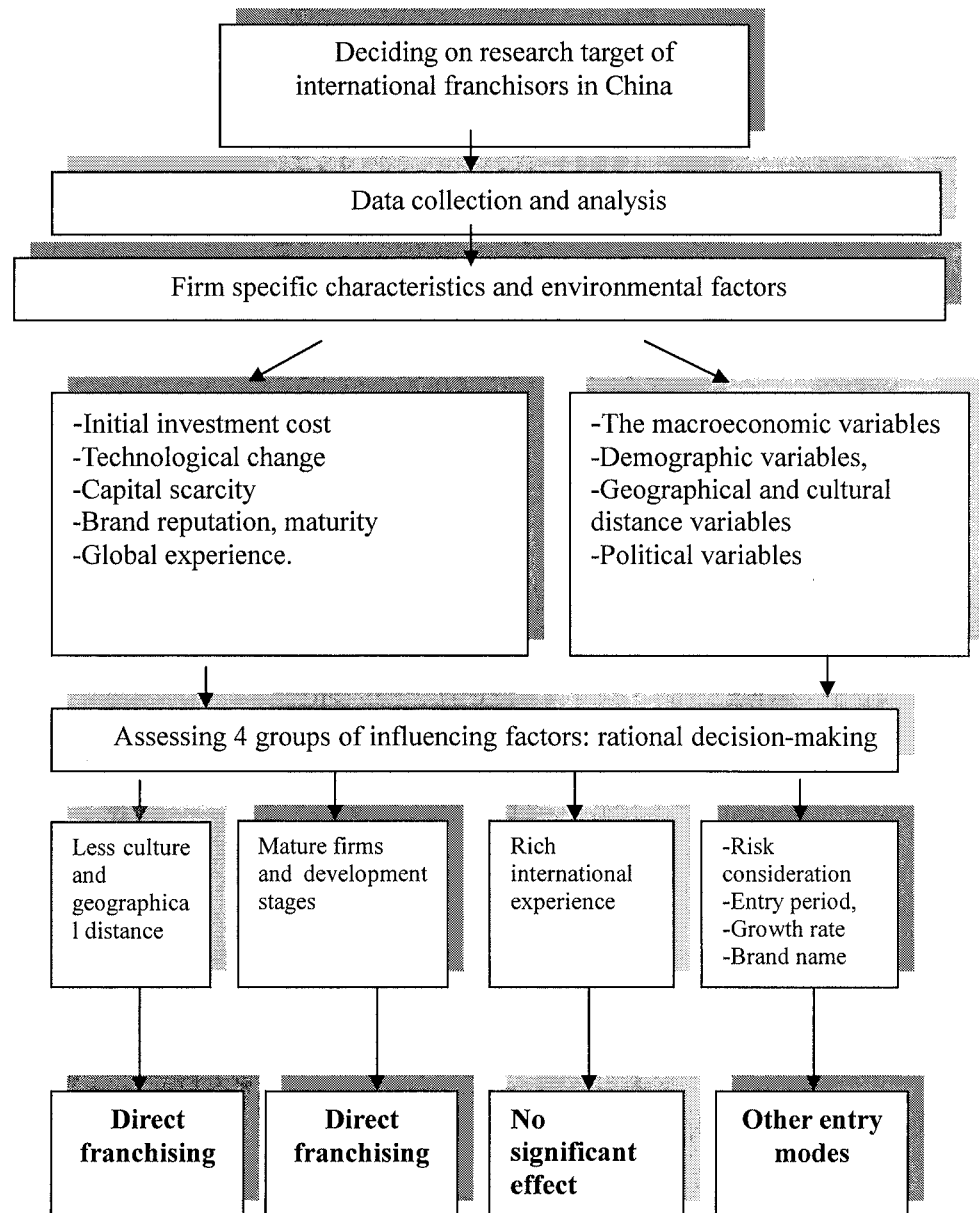
The objective of this study is to investigate the important factors that influence international franchising entry mode choice in the Chinese market. The research suggests that a large number of factors, including both firm specific characteristics and environmental factors, have significant impact on franchising entry mode choice.

These firm specific characteristics include: initial investment cost, technological change, capital scarcity, brand reputation, maturity and global experience. The environmental factors include the macroeconomic variables, demographic variables, geographical and cultural distance variables, and political variables.

To identify the important factors in determining the franchising entry mode in China, the author first discussed the unique features of franchising as an entry mode and developed five hypotheses on the basis of existing literature. Secondly, carefully designs of the research and a quantitative survey were conducted with the specific focuses upon the international franchisors operating in Chinese market. Finally, conclusions are derived from the survey data via testing the developed hypotheses

Building upon the findings of this research, a practice-based framework has been developed for practitioners (see figure 7.1).

Figure 7.1 Factors influencing international franchisor's entry mode choices in China



7.2.1 The Direct Franchising Entry Mode and its Influencing Factors

The research results suggest that Asian firms are more likely to choose direct franchising than the firms coming from North America and Europe. This implies that the less the culture and geographical distance between home country and host country, the more likely the international

franchisors adopt direct franchising in China. Firm maturity has an important effect on franchising entry mode: the firms in expansion stage are more likely to choose direct franchising than the firms in introduction stage. Mature firms are more likely to choose direct franchising than the pre-mature firms. The more international experience a firm possesses, the less likely the firm would adopt direct international franchising entry modes in China.

The reasons of the international franchising firms that like to adopt direct franchising in China are that the franchisor directly establishes and runs individual franchisees in a new environment, which may be very different from the home market. This method often requires a franchise 'packet' which is carefully planned to suit the particular country involved. Again, some difficulties exist in managing such operations from a distance, especially when the number of franchisees increases. In the case of major social and cultural distances between the domestic and foreign market, direct franchising is the least likely entry route due to the problems of finding suitable franchisees and providing operational support and control (Mendelsohn, 1992). Because the huge difference between Chinese culture and Western culture, the difficulties of direct franchising far outweigh the advantages of it. The research results indicated that direct franchising is not the most suitable mode for America and European franchisor to enter China. It is not quite suitable when the franchisor seek to enter a country that is culturally different from the franchisor's home country. It is more suitable for the franchisors that come from culturally kindred countries to

use direct franchising, like neighbouring countries and regions in Asia.

7.2.2 Other Entry Mode and its Influencing Factors

The research indicated that international firms from North America and Europe and are more like to adopt joint venture entry mode when entered the Chinese market, because the presence of a Chinese franchisee that knows the territory and has the resources to develop the market. This is an essential bridge between the franchisor and the franchisee. A knowledgeable and resourceful master franchisee can make the difference between the success and failure of a venture. So if the international franchising firms have much culture and geographic distance between domestic markets and China, it is suitable for them to use other entry mode choice. If the international franchising firms are at introduction stage, other entry mode choice is a suitable entry mode for them to enter China. If the international franchising firms are without international operation experience, it is suitable for them to adopt other entry mode choice.

With a master franchise agreement, the franchisor grants the master franchisee the right to sub-franchise the franchisor's concept to others within an exclusive territory, thereby creating a three-level franchise relationship. For the franchisor such arrangements mean that most of the work involved in expanding the operation in the Chinese market is carried out by the Chinese franchisee, thereby reducing the demands on the franchisor. A further advantage is that the Chinese partner understands the local conditions better than the franchisor and is, therefore, in a better

position to handle cultural and language barriers, bureaucratic red tape, political problems and so on. The Chinese partner is viewed therefore not only as a source of revenue for the company but also as a source of information about what aspects of the marketing programme may need to be altered to the values of the Chinese market. Furthermore, the Chinese partner has an investment in the business and, consequently, is more committed to seeing the business succeed. However, control of the quality of the network's operations is crucial and difficult to maintain. In addition, there is the possibility that the large, established international operator, which adds joint venture to its portfolio of entry methods, may in practice underestimate the social, economic and cultural differences China. As a result, this can often necessitate substantial adaptations and modifications to the original product, systems and marketing.

As for master franchisee in China, it can leverage the master franchisee's resources and knowledge of the local market conditions to get off the ground quickly. Also, the master franchisee can establish a successful franchise operation to generate and promote sales of sub-franchises. But it has its own disadvantages too. The involvement of the master franchisee can reduce the profits of both the franchisor and the sub-franchisee. The research also indicted that there lack a pool of potential knowledgeable and resourceful master franchisee with business experiences, capital, and the willingness to undertake investment risk. The new international franchisors have to take these factors into consideration when they choose their entry mode choice in China.

7.2.3 The new Findings

Comparing with the previous research, factors of the entry period, brand name, experience and risk are the new findings that the international franchisors have to take into account when enter other countries such as USA, Russian and India, but it is not to be supported in the scenario of this case. The research result in Section 5.5.1 indicates that these factors do not have significant effect on entry mode choice in the Chinese market.

7.2.4 Highlights of the Research

From a practical point of view, the main purpose of this research is to focus on what factors the international franchising firms have to take into consideration when they choose franchising entry mode in the Chinese market and help them to avoid recommitting the same errors.

One of the objectives is to test the macro environmental factor influencing market entry mode of international franchising firms. Through the data analyses, the author draws the following conclusions.

(1) Economic environment

China has been regarded as one of the most potential franchising markets in the world with its large population and vast territory. Moreover, the reform towards a market economy and a large amount of migrating people help create a better business environment for international franchising organizations.

(2) Demographic Environment

Demographic Environment includes age, gender, education, income etc. In China, more and more women are entering the working force and the average education level is increasing year by year. This is a positive trend for international franchisor to enter China.

(3) Cultural Environment

As China has a unique culture and business tradition, franchisors in China should put some efforts in understanding Chinese culture. The major characteristics of Chinese commercial culture are as follows: entrepreneurial style (looking for short payback periods and being acutely conscious of risk and control), closely held control, nepotism (family members actively involved in franchising operations). Take these characteristics into account; the franchising system should be adapted to a more specific context with a certain degree of flexibility. An understanding of the commercial culture in China is crucial. Sometimes it is necessary to adjust the foreign-based products according to the market and its particular segments while keeping the consistency as a franchisor.

In addition, “guanxi”(personal connections and favouritism) plays an important role in business, when searching for a business partner or even closing a transaction. It could also ruin a business. As franchising is a process of networking, wide and tight business connections with custom, tax, etc are helpful to establish a franchising system.

(4) Legal Environment

The franchisor wish to tap China's potential market must take into account all the legal rules and regulations which must be complied with. Franchise Measure in Feb 2005 is the trial implementation law governing franchising now. Besides it, Contract Law and other mandatory laws such as the Labour Law, Land Use Regulations, Tax Laws and the various intellectual laws all provide a primer on the legal considerations of franchising in China. The cornerstone of every franchise is the transfer of trade secrets and intellectual property, but it is not clear to which extent the franchisee is allowed to continue using the acquired know how once a franchise is terminated. Also, because many industries, most importantly the retail industry, is not fully open to foreign investment, some foreign franchisees have to operate in a gray area of the law. The franchise law needs to be amended to clarify open issues and to provide a legal environment in which both domestic and foreign franchises can safely operate.

7.3 Contribution and Implications

In the introduction chapter in this thesis, the author stated that one of the important objectives of this research is to make contributions to business practice rather than only focusing on advancing theory. The key contributions of this research to the literature are summarized as follows.

7.3.1 Contributions to Literature

International market entry strategy is an important issue in a firm's internationalization. Although there is a large literature on the study of determinants of international franchising entry mode choice, only little study focuses upon the case of international franchisors' entry strategic choices in China. Unlike previous research, which were generally confined to the activities of large multinational enterprises from Western developed countries to developed countries, this study has offered some new in depth insights that has extended mainstream foreign investment theory and provided a different way to understand international franchising giants market entry strategies in the context of international franchisors from developed countries entering developing countries. With rapid transition into market economy and globalization, China provides a large market for international franchisors and this market expands rapidly.

This study filled the gap by investigating important factors which influence the international franchisors' entry mode choices with the specific focus on the China case. It contributes to literature in that it broadens the knowledge on international franchising strategy. Culture distance; geographic distance; expansion stage and firm at mature stage are the key factors influencing the international franchising firms to adopt direct franchising in China. While risk spreading is the key factor influencing the international franchising firms to adopt direct franchising, but it is not the case for firms from America. International experience has no correlation with the entry mode choice in China. This study has

extended the research by gaining more insightful understanding of the factors which business managers actually should take into consideration in their entry decision making.

The main findings of this study are consistent with the literature, and some implications are derived from this research. This study suggests that cultural and geographic distance, experience, and life cycle development play an important role in international franchisor's market entry decision in the Chinese market. This finding implies that extra attention has to be paid to new arising markets in developing countries for better understanding on international franchising theory.

7.3.2 Contributions to Practice

In the introduction section of this thesis, the author stated that one of the important objectives of this research is to make contributions to practice rather than only focusing on advancing theory.

This research has very important managerial implications in relation to the international franchising modes of entry. Unlike previous studies, this study extends the existing knowledge on international franchising entry strategies by investigating the international franchising firm's entry into China.

From an operational level, the framework which is mainly based on quantitative research method developed in this study provides international

franchising firms' managers an extensive understanding of entry mode choices and helps them better address the totality of the multidimensional and complex entry mode decision.

7.4 Limitations and Direction for Future Research

7.4.1 Research Limitations

According to, Taylor, Zhou and Gregory (2000), no matter how well designed the research was, every study has its limitations. Without exception, this study suffers from a number of limitations that are discussed as bellows.

First, although the sample firms are random selected, the informants' knowledge background and practical experience may create the bias for this study. Also the informants' cooperation, enthusiasm, and attitude during the research may significantly affect the quality of the data. Second, the survey was carried out in several large cities where most of the international franchising firms enter Chinese market at very beginning. This will cause some bias due to the different economic environment and sub-business culture in different locations such as the differences between South and North in China.

7.4.2 Suggestions for future research

Regarding the performance of these international franchisors in China, this research does not put much effort on it. This research is at the initial stage and focuses on the entry mode choice, future research can find out: what are their performances by choosing these entry modes, good or bad? Do

they change their initial entry mode after 2-3 years? Considering national culture difference, future research may separate these franchisors by American franchising company and British franchising company or French franchising company as the culture differences amongst these countries might different in their entry mode choices. The author suggests that the different industry should be separated (e.g fast food, retailing, service) in the future research.

Future research calls for more detailed information on the firm characteristics of international franchisors and the environment of local markets. There are possibly more related factors which might affect the international franchisors' entry mode choices, the in-depth interviews in the future research can identify them.

This study shows that culture distance has significant impact on franchising strategy. An interesting question in future study is how culture can influence international franchising in China. Future studies in this area may provide further evidence about the factors that influence international franchising firms' market entry strategy decision-making process.

7.5 Reflection of Personal and Professional Development

To be a mature doctoral student is not an easy task for the author. Living, working and studying as a professor in Chinese university in China, the author faced a lot of challenges form the beginning to the end. In this section, the author intends to reflect how her professional skill has been

developed and what difficulties and challenges have been faced during this research journey.

7.5.1 Reflections on the Process of Data Collection

The process of select participants was somewhat difficult. Firstly, the organisation should successfully develop in China so that they might be happy to cooperate with the author. Secondly the author should send the questionnaire to the owners or top managers; otherwise the research cannot gain a general picture and details, because market entry strategy implementation is normally carried out in a top-down management system. In order to let top managers or decision makers fill up the questionnaire, the author send e-mail to show thanks first to those managers, following up by telephone calls.

The amount of time taken to sort out of the data was overwhelming. Calculating the data needs very strong background of maths and statistic skills. These are lessons for the author to learn and it will be very useful for future research.

7.5.2 Reflections on Personal and Professional Developments

7.5.2.1 Professional Developments and Academic Achievements

According to Turner (1996), professional development mainly focuses upon individual development in a specific area. Underlying professional developments, people's learning and additional skills in specific area should be enhanced. In the case of this DBA study, the professional development is related to business management area with the specific

focus upon the international franchisors' market entry mode choices when entering the Chinese markets. The author became marketing consultant for several international franchising systems, such as Super 8 and Quanjude Beijing Duck Company after the first year of DBA study. Purposely, one of the initial motives of doing DBA was to improve the author's individual professional and organizational performances. After 5 years struggling and hard working, the researcher has acquired more knowledge and business practice experience through her DBA study.

Firstly, conducting this research helped the author to understand more about the international franchising internationalization. Theoretically, in completing this study, comprehensive literature review has been done in relation to international franchising internationalization, with the specific interest of their foreign market entry mode choices. Having been discussed earlier, this research problem was identified from the pure theoretical gaps. Doing critical literature review helped the author to develop a comprehensive understanding of international franchising strategic market entry choices from the theoretical perspective.

Secondly, from a practical standpoint, the findings of this research enable the researcher to get more insights to international franchising firms' managers' foreign market entry decision-making practices from the real-life case. Combining above two aspects together, this project comprehensively and systemically enhanced the author's understandings and reshaped her knowledge of franchising internationalization.

Thirdly, doing this research enriched the author's practical research skills. At the beginning of DBA, the author has limited knowledge about research philosophy and methodology. it was a big challenge to her. Through appropriate training and practical exercises during DBA study, the author gradually learn more about qualitative and quantitative research methods, especially quantitative approach. Consciously, this research involved massive information seeking and extensive time has been spent in conducting questionnaire for data collection. In return, these practical research skills are most important capacities for the author for her future research. Most valuably, this research developed the author logical and critical thinking.

Fourthly, this DBA study enhanced the author's career development. It helped the author to develop her theoretical knowledge and practical management skills to promote her career success. The author is now teaching two franchising subjects of franchising and international franchising which involve the firm's international market entry choices. The author benefits a lot from DBA research.

Reflecting the whole research, DBA not only made the author achieve a high academic standard, but also gave her an opportunity to put knowledge into practice. For instance, the author was invited by the Australian Trade Association to make a speech at its 2005 Franchising Expo held in Sydney. The author also was invited to be the keynote speaker at China Franchising

Expo 2003, 2004, 2005 and 2006. This made the author famous as the expert in franchise field. In the last five year, the author attended two international conferences, one was in Mexico in 2003, and the other was in Korea in 2006. Two textbooks about franchising were published. One paper is published in the Journal of China Technology Transfer in the UK; one paper was published in the Journal of Harvard Business Review (Chinese version) in 2004. All these achievements have closely linked to the DBA study.

7.5.2.2 Challenge and Difficulties

Reflecting upon this DBA research journey, there have been a numerous times of challenges and difficulties in completing this study. The most unforgettable challenges and difficulties are how to balance work and research as well as the conflicts between family life and research.

Apparently, the completion of DBA is an important achievement. However, the learning process perhaps is the most valuable thing. To be strong, insistence and positive are essential help the author to continue her personal and professional development in the future.

7.5.2.3 Lessons Learned From the Research

It is clear that at the beginning of the research, the researcher's understanding of internationalization theory was insufficient, as the study progressed, the author gained more confidence and knowledge of international franchising theory from the literature review, and also from

other source to bridge this knowledge gap.

Another important lesson the author learned from this research was about how to choose and adjust the research method and the research process in an open and flexible way. On the other hand, the DBA training course provided useful guidance in research methodologies' utilisation; it widened the researcher's outlook as to what kind of research approaches can be chosen and how they can handle them with ease. Meanwhile, the DBA training course also invited some guests' speaker to share their research experiences, in order to help new researchers gain a brief idea of research process and issues that should be given attention. The author made great progress in each step of training.

7.6 Chapter Summary

This chapter has illustrated the research contributions to understanding of foreign direct investments from both theoretical and practical perspectives. In particular, it brings great insights to international franchising firms' managers in their foreign market entry mode choices under the context of entering the emerging market, such as China. Moreover, this concluding chapter has drawn a close upon the author's reflections of her personal and professional developments by conducting this DBA research. To do this, the author has reflected her learning experience by examining how this DBA study built up her competencies of business management knowledge. Furthermore, the author also highlights challenges and difficulties she engages during this research process.

Overall, the research provides some guiding principles for future international franchising firms when they decide to franchise in China.

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Appendix A: Index

CCFA: China Chain and Franchising Association

CJVs: Cooperative joint ventures

FDI: Foreign direct investment

FTZs: Free Trade Zones

ICRG: International Country Risk Guide

IFA: International Franchising Association

KFC: Kentucky Fried Chicken

MNCs: Multinational corporations

SEZs: Special Economic Zones

SME's: Small and medium enterprises

WOFEs: Wholly- owned foreign enterprise

WTO: World Trade Organization

Appendix B

Summary of U.S. Published Articles on Franchising in Emerging Markets

| Year | Title | Author(s) |
|------|---|--------------------------------|
| 1998 | Franchising in Asia | Justis, Neilson And Yoo |
| 1998 | International Business Format Franchising and Retail Entrepreneurship: A possible source of retail know-how for developing countries | Kaufmann and Leibenstein |
| 1990 | Franchise Management in East Asia | Chan and Justis |
| 1991 | Opportunities and Challenges for Franchisors in U.S.S.R.: Preliminary Results of a Survey of Soviet University Students | Welsh and Swerdlow |
| 1992 | The Future of Franchising in the U.S.S.R.: A statistical Analysis of the Opinions of Soviet University Students | Swerdlow and Welsh |
| 1992 | Franchising Opportunities in the Free Trade Zones of Developing Countries | Grimaldi |
| 1992 | Pizzas in Mexico? Si! | Willems, English, And Ito |
| 1992 | Franchising Entry and Developmental Strategies in the Former Soviet Union | Christy and Haftel |
| 1993 | Pizza Hut in Moscow: Post-coup System Development and Expansion | Christy and haftel |
| 1993 | A Cross Cultural Study of American and Russian Hotel Employees: A Preliminary Review and Its Implications for Franchisors | Welsh and Swerdlow |
| 1994 | A Survey of Franchising in Singapore | Chan, Foo, Quek, And Justis |
| 1994 | Franchising in China: A Look at KFC and McDonald's | English and Xau |
| 1994 | Does Business Format Management Mast5er Marxism in Post-Coup Russia? | Swerdlow and Bushmarin |
| 1995 | Franchising in Brazil | Josias and McIntyre |
| 1995 | Franchising in India: An introduction | Paswan and Dant |
| 1995 | Franchising in Indonesia | Chan and Justis |
| 1996 | Franchising in South Africa | Scholtz |
| 1996 | Franchising into Asia: An Overview of Selected Target Markets | McCosker |

| | | |
|------|--|------------------------------|
| 1996 | Local Franchising Development in Singapore | Goh and Lee |
| 1996 | The Case of the Elegant Shoplifter, Shuwaikh, Kuwait | Welsh, Raven, and Al-Bisher |
| 1997 | Franchising as a Tool for SME Development in Transitional Economies: The Case of Central European Countries | Sanghavi |
| 1997 | An Overview of South African Franchising | Scholtz |
| 1998 | NAFTA and Franchising: A Comparison of Franchisor Perceptions of Characteristics Associated with Franchisee Success and Failure in Canada, Mexico, and the United States | Falbe and Welsh |
| 1998 | Franchising in Slovenia: Support to the Development of Franchise Systems in Central Europe | Pavlin |
| 1998 | Case Study: Strategic Alliances in International Franchising—the Entry of Silver Streak Restaurant Corporation into Mexico | Hadjimarcou and Barnes |
| 2000 | New Trends in Slovenian Franchising | Pavlin |
| 2000 | International Franchising: Evidence from U.S. and Canadian Franchisors in Mexico | Lafontaine and Oxley |
| 2001 | International Franchising in China: An Interview with Kodak | Alon |
| 2002 | American Franchising Competitiveness in China | Alon, Toncar, and Lu |
| 2005 | The International Business Environments of Franchising in Russia | Anttonen, Tuunanen, and Alon |
| 2005 | Real Estate Franchising: The Case of Coldwell Banker Expansion Into China | Alon and Bian |

Source: From Welsh, Alon and Falbe (2006) “An Examination of International retail franchising in emerging markets, *Journal of Small Business Management*, 44(1), PP 140-141

Appendix C:

Questionnaire Survey

Survey on Factors of International Franchising Entry Mode Choice in China

For this research, we would like to know what factors influence international franchising firm's strategic choice in China. All information is anonymous, and will be used for no other purpose than this. Please give us no more than 10 minutes. It will be of great help to us! The questionnaire will be carried out in accordance with the Market Research Society Code of Conduct. If you need any help from us, please do not hesitate to contact us. Tel: 010-64493289 E-mail : zhumingxia@uibe.edu.cn Thank you very much for your assistance!

Part A: Your Firm's General Situation of Operation in China

Q1. When did your firm enter China?

1985-1989 ☐ 1

1990-1999 ☐ 2

2000-2005 ☐ 3

Q2. Please indicate if your firm is part of a joint venture, or is wholly owned.

Joint venture ☐ 1

Wholly-owned enterprise ☐ 2

Q3. Please indicate the type of your firm's initial market entry choice in China.

Direct franchising ☐ 1

others ☐ 2

Q4. Check the industry your company belong to in China.

Food industry ☐1

Other service industries ☐3

Q5. The home country of your parent company is:

North America ☐1

Asian ☐2

Europe ☐3

Others ☐4

Q6. The initial location of your venture in China.

Large City ☐ 1

Provincial capital ☐ 2

Small and medium cities ☐ 3

Others ☐ 4

Q7. Did your firm face the problem of capital scarcity when entering into china?

Serious capital scarcity problem ☐1

Capital was a little scarce ☐2

The same as other period ☐3

Capital was abundant ☐4

Q8. How many total outlets (stores) do you have in China?

Less than 50 ☐ 1

50-200 ☐ 2

200-500 ☐ 3

500-800 ☐ 4

Above 800 ☐ 5

**Part B Consists of factors affecting international franchising
firm's entry mode in China.**

Q9. In your opinion, your reputation and brand recognition is

Very high ☐1

High ☐2

Normal ☐3

Scarcely knew ☐4

**Q10. What was the Development stage of your franchising system at
the time of your entry into China?**

Penetration (Operation years 0-5, outlet number 0-10) ☐ 1

Growth (Operation years 6-8, outlet number (11-39) ☐ 2

Gradually getting mature (Operation years 9-13, outlet number 40-99) ☐ 3

Very mature (Operation years over 14, outlet number over 100) ☐ 4

**Q11. Please stage the franchising life-cycle of your firm' at the time of
entry into China.**

Introduction ☐ 1

Expansion ☐ 2

Maturity ☐ 3

Decline ☐ 4

**Q12. Did you have any experience in operating in other countries
before entering into China?**

A lot of experience ☐ 1

Some experience ☐ 2

Very little experience ☐ 3

No experience ☐ 4

Q13. Do you agree that franchising is considered to be a relatively low-cost, low-control entry mode choice for international franchising firms to access the Chinese market?

Yes ☐ 1

No ☐ 2

Q14. Do you think of the GDP growth of Chinese economy has some positive impacts on your market expansion in China?

Yes ☐ 1

No ☐ 2

Q15. Do you consider risk spreading?

A lot of consideration ☐ 1

A little consideration ☐ 2

Very little consideration ☐ 3

None ☐ 4

Q16. When you plan to expand your business in China, how do you consider the situation of the franchising market development?

Very mature ☐ 1

Gradually getting mature ☐ 2

Not much mature ☐ 3

Franchising market is blank ☐ 4

Q17. How much do you know about the targeted market when you plan to enter China?

Completely know ☐ 1

Partly know ☐ 2

Know very little ☐ 3

Never did market research ☐ 4

Part C: Specific Questions

The following are a series of questions regarding the importance of your decision to select the above mentioned venture in China, unless stated otherwise. To each question, please circle the most appropriate number.

Q18. How important do you think the following factors influencing your firm's entry mode choice in China? (Please tick the number, 1 being very important, 5 being unimportant.)

| | VeryImportant | | | | Unimportant |
|----------------------------|---------------|---|---|---|-------------|
| 1. Brand name | 1 | 2 | 3 | 4 | 5 |
| 2. Technical knowledge | 1 | 2 | 3 | 4 | 5 |
| 3. Political uncertainty | 1 | 2 | 3 | 4 | 5 |
| 3. Law and regulations | 1 | 2 | 3 | 4 | 5 |
| 4. Initial investment cost | 1 | 2 | 3 | 4 | 5 |
| 5. Technological change | 1 | 2 | 3 | 4 | 5 |
| 6. Type of product | 1 | 2 | 3 | 4 | 5 |

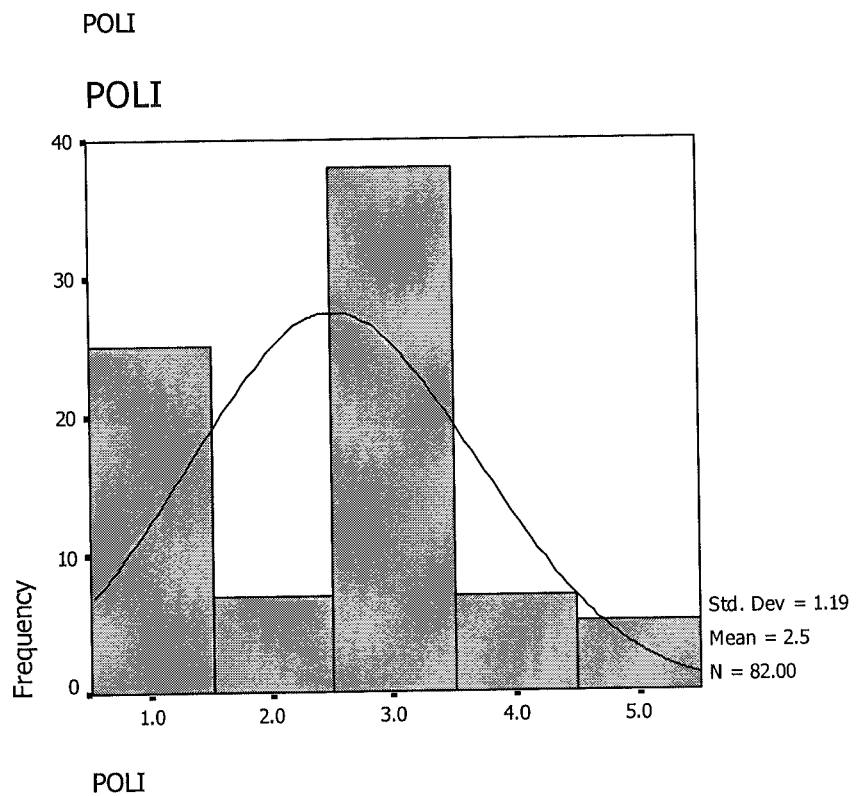
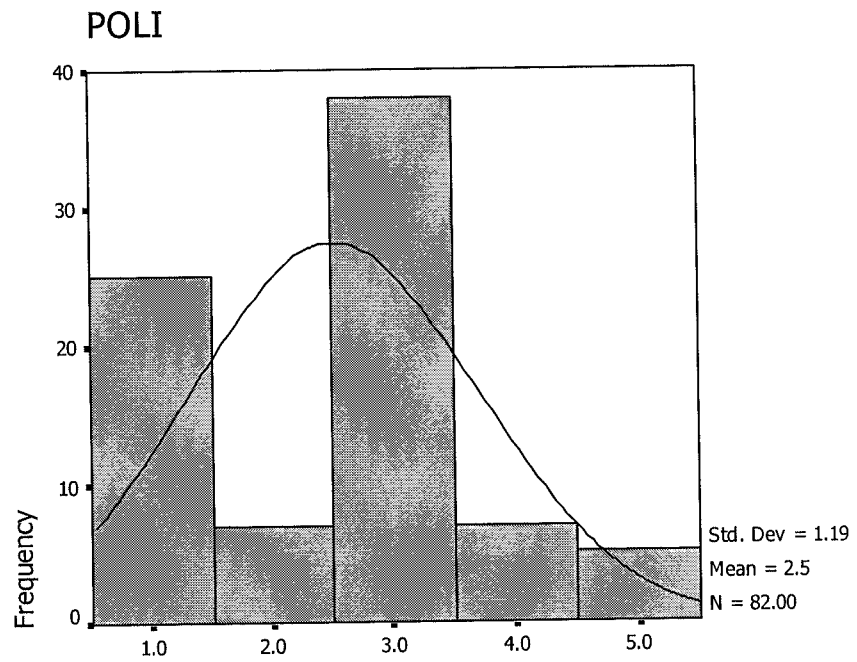
Part D Open questions

Q19. What else factors do you think affecting your entry mode choice in China?

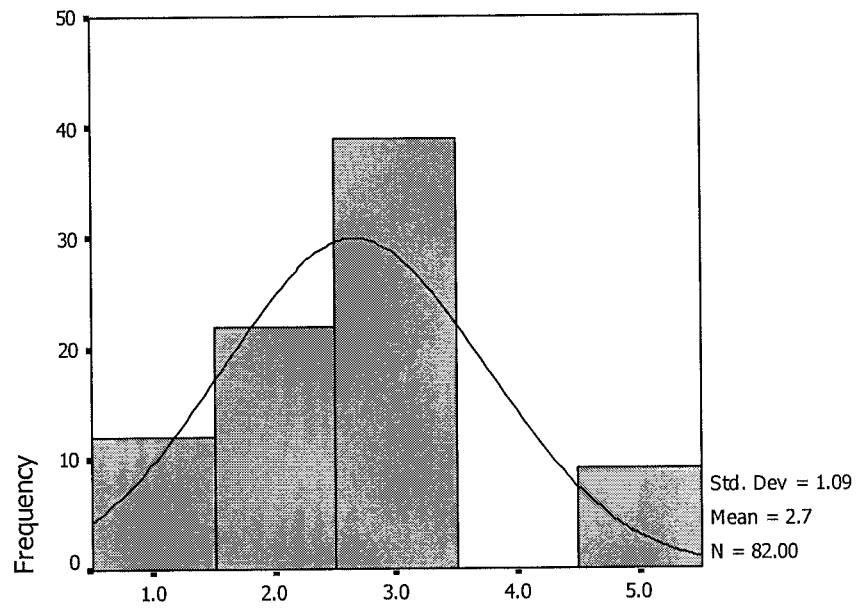
Q20. Please make some suggestions and comments for other international franchisors who plan to enter the Chinese market.

THANK YOU VERY MUCH FOR YOUR GREAT HELP WITH THIS PROJECT!

Appendix D Frequency of Factors

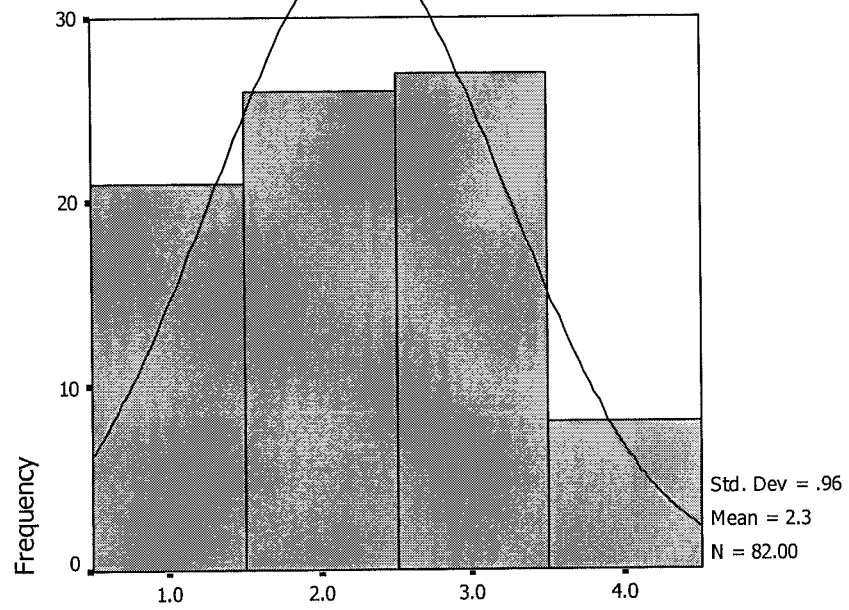


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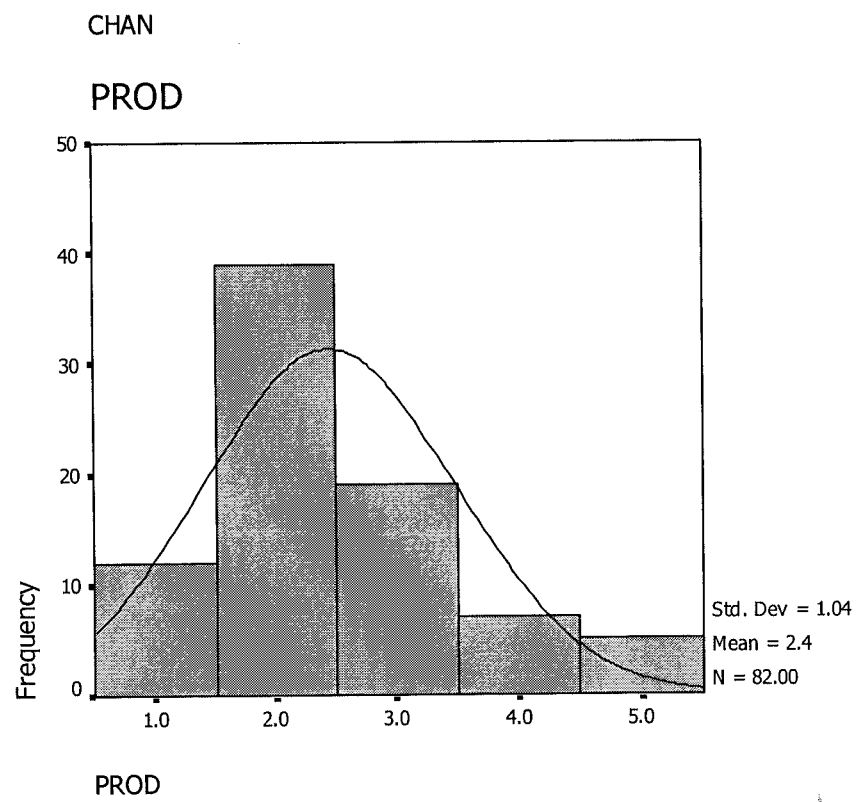
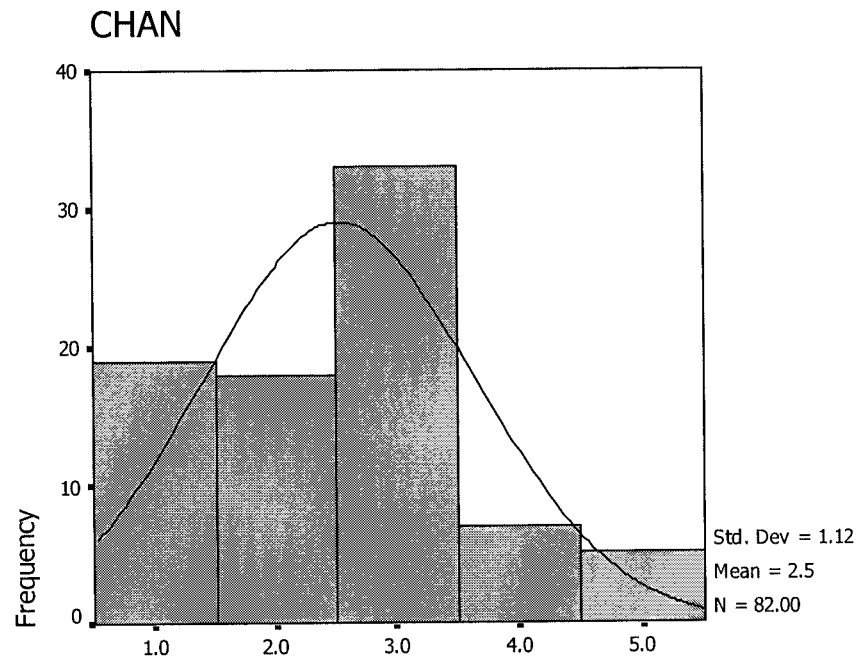


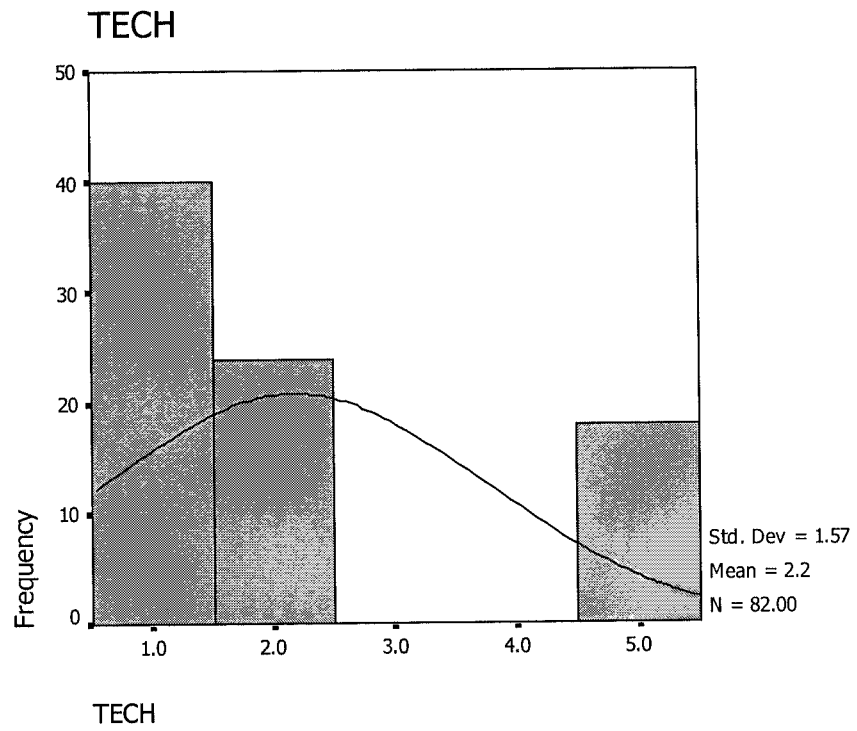
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COST



COST





Appendix E

Interview Questions

1. Tell me about your business, including your parent company and your foreign venture (s).
2. When did your firm come to China?
3. Why did you choose China as your expanded target market?
4. Will you please give me a brief introduction about your firm?
5. Could you please tell me what are entry strategies of your firm in China?
6. What other market entry mode(s) did you choose when initially entering the Chinese markets?
7. Are you satisfied with the entry mode you chose when you initially entered China? Why or why not?
8. What are the factors influenced your entry mode decision?
9. As an American company, what do you think of the most popular form of expanding business strategy in China?
10. Was your strategic entry decision made individually by the owner manager or by a management team collectively?
11. There are two mainly used entry modes nowadays. One is direct international franchising, the other is master franchising. Which one did you use?
12. Why did you choose other entry mode rather than direct franchising as you adopted in some other countries?
13. Are there any other modes of entry into China?
14. What are the most important factors affecting franchising in China?
15. What competitive advantages do you think your company has? How did these advantages affect your market entry mode choices?
16. Tell me about the decision maker's personal profile (may be yourself). How do you describe the decision maker's personality?
17. How do you describe cultural differences between westerners and Chinese? What are your suggestions for other firms?
18. Have these cultural differences been taken into account in your market entry mode choices? Why and how?
19. What is your performance in China?

20. What was the most difficult thing you encountered when you were making your entry mode selection? What other problems have you had in deciding your initial entry mode choices?
21. Are there any further comments or suggestions which you want to give to other international franchising managers who are going to invest the emerging countries?